Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-3041

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

against

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE
SUPREME COURT OF THE UNITED STATES

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

-against-

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners herein pray that a Writ of Certiorari be granted by this Court to review a determination of the United States Court of Appeals for the Second Circuit, made June 28th, 1974, which affirmed a determination of the United States District Court for the Southern District of New York, made December 3rd, 1973 which granted the

defendants' Motion for Summary Judgment upon the ground that the Securities and Exchange Commission had primary jurisdiction over the fixing of Commission Rates for Stock Trades. The Petitioners contend that the determination of the Court is not well taken and should be reversed.

JURISDICTION

Jurisdiction of this Court to review the determination of the United States Court of Appeals for the Second Circuit is given by 28 USC 1254(1). This petition is being made by the plaintiffs in the cause below, parties to said action.

TIME

The determination of the United States Court of Appeals for the Second Circuit was made on June 28th, 1974. This petition is being filed within ninety (90) days from the date of said determination.

REASONS WHY THIS PETITION SHOULD BE GRANTED

This case involves almost every Rule of this Court warranting the grant of a Petition for a Writ of Certiorari. This case is:

1—Of great public importance. Both the US Department of Justice and the SEC submitted briefs on opposite sides of the question.

2—There is a conflict between circuits in the application of the legal principles involved.

3—There are grave constitutional questions involved in this appeal.

4—There is a conflict between the determination of the Court of Appeals for the Second Circuit and prior determinations of this Court including *Silver v. New York Stock Exchange*, 373 US 341.

FACTS

This case involves the legality of the "fixed commission rates" charged by the New York Stock Exchange and the American Stock Exchange.

Since the inauguration of stock trading on the defendant Stock Exchanges the exchanges have had various rules providing for the fixation of commission rates to a certain minimum amount. The Rules further provide that any members of the said Exchanges who violate the Rules and charge Commission Rates lower than the fixed amount will be expelled from the Exchanges.

The Exchanges also have "Anti-Rebate" rules which prevent division of commissions with non-members of the said Exchanges, also under penalties of expulsion from the exchanges.

The defendant Stock Exchanges are the primary market

for the sale of securities to the general public. While there is some trading "off the board" where the facilities of the defendant Stock Exchanges are not used for "listed securities" and there is also an active "over the counter" market for unlisted securities the primary securities markets are the defendant exchanges.

In order to properly survive in the Securities Business, therefore, it is necessary to be a member of the defendant Exchanges or at least one of them.

Use of the facilities of the defendant Exchanges are limited to "members" thereof. The "memberships" in the defendant exchanges are limited and a "seat" (or membership) can be purchased only by buying some other party's "seat". The price paid for such a "seat" is generally determined by the trading volume at the particular time that the seat is sold.

The plaintiff Gordon is an investor in Securities traded on the defendant Exchanges. The plaintiff Independent Investor Protective League is an organization of investors who invest in securities listed on the defendant Exchanges. The members of the Independent Investor Protective League and the plaintiff Gordon are vitally affected by the fixation of Commission Rates by the defendant Exchanges.

The Securities and Exchange Commission (organized in 1933) until about the time of the commencement of this action, took no action with respect to the fixation of Commission Rates. Indeed, even after making a "letter

determination" that it would "not object" to certain practices with respect to (1) instituting a "surcharge" on transaction of less than 1000 shares, (2) instituting a "volume discount" on large transactions and (3) instituting a negotiated commission schedule on transactions in excess of $500,000 (now $300,000), the Commission, in two cases where judicial review was sought on that issue, represented to the Court that it, in fact, had no jurisdiction to fix Commission Rates. In the Commission's brief filed in connection with the dismissal of the Petition for Review in the United States Court of Appeals for the Second Circuit taken by the plaintiffs against the "letter opinion" stating that the practices suggested by the New York Stock Exchange would not be objected to by the Commission stared as follows:

> "*** The Commission's letter of comment to the Exchange did not order the Exchange, petitioners, or any other person to do or to refrain from doing anything. Nor did the letter "approve" or "disapprove" the Exchange's proposals.***"

This brief resulted in a dismissal, without opinion, of the plaintiff's Petition to Review the determination of the Securities and Exchange Commission. (Docket 1984-71).

Petitioners then sued the Commission in the United States District Court for the District of Columbia. Again the Commission, in its brief seeking dismissal of the Complaint, stated as follows:

> "*** However, the question of the type and extent of immunity that may flow from Commission determinations regarding exchange rules and practices need not be decided in this case. The appropriate forum for resolution of that question is in an antitrust action against a self-regulatory organization challenging its rules or the administration of such rules.***"

This brief also resulted in a dismissal of the plaintiffs' complaint.

The last determination of the Commission, made after hearings with respect to Commission Rates, and which permitted fixed commission rates to remain in effect was again challenged in a Petition for Review to the United States Court of Appeals for the Second Circuit. The plaintiffs again attempted to challenge this determination and again was met with a Motion to Dismiss on the ground that the Commission had not issued a reviewable order. This motion was again granted by the Court of Appeals without opinion.

Despite the recited prior history the District Court and the Court of Appeals, determined that the Securities and Exchange Commission had full jurisdiction over the fixing of Commission Rates, that, as a result, the defendants had full anti-trust immunity, and, as a result, the petitioners had no cause for Complaint.

POINT ONE.

THE EXTENT OF ANTI-TRUST IMMUNITY ON THE PART OF THE INVESTMENT COMMUNITY BY REASON TO THE SECURITIES ACTS IS A QUESTION OF GREAT PUBLIC IMPORTANCE WHICH SHOULD BE REVIEWED BY THIS COURT.

The Court of Appeals, in affirming the determination of the District Court, in its opinion, stated that:

> "*** Whether the minimum rate structure presently employed by the nation's stock exchanges enjoys immunity from attack under the antitrust laws is a question of such importance that we need not belabor its significance.***"

Where a question of great public importance is presented, which has not been previously decided, this Court will, in general, grant certiorari to consider the question. See for example, *Engel v. Vitale*, 370 US 421 (prayer in schools), *International Brotherhood of Teamsters v. Vogt*, 354 US 284 (power of a state to enjoin picketing), *FCC v. RCA*, 346 US 86, *Textile Workers Union of America v. Lincoln Mills of Alabama*, 353 US 448, *NLRB v. Lion Oil Co.*, 352 US 282, *Sperry v. State of Florida*, 373 US 379 (question of State Bar's power to exclude a non-member of State Bar from practicing before Federal Agency), *Theard vs. US*, 354 US 278, *J.I. Case Co. v. Borak*, 377 US 426, *SEC v. Variable Annuity Life*

Insurance Co. of America, 359 US 65 (power of SEC over variable annuity contracts) and *Otis & Co. v. SEC*, 323 US 624 (extent of SEC regulatory power).

In this case, it is submitted, that a determination by this Court as to the nature and extent, if any, of the anti-trust immunity enjoyed by the defendant stock exchanges and brokerage community must be made by this court.

POINT TWO

CERTIORARI SHOULD BE GRANTED IN THIS CASE TO DETERMINE THE CONFLICT BETWEEN CIRCUITS OF THE PRESENT CASE AND THE *THILL* CASE WITH RESPECT TO THE NATURE OF ANTI-TRUST IMMUNITY WITH RESPECT TO STOCK EXCHANGE RULES.

The present action stands for the proposition that the defendant Stock Exchanges, and the brokerage community, are immune from the anti-trust laws so long as the SEC has regulatory power over such rules (even if the power has not been exercised). In the Seventh Circuit case of *Thill Securities Corp. v. New York Stock Exchange*, 433 Fed. (2nd) 264, certiorari denied, 401 US 994, the Court there held that the "anti-rebate" rule (which impliedly permitted fixation of commission rates) was not immune from the antitrust laws. The Second Circuit, in distinguishing *Thill* also stated as follows:

> "*** And it would be difficult to maintain that the effect of the anti-rebate rule on investor protection, fair dealing in securities or fair administration of an exchange is in any respect different from the practice of commission rate fixing. *** Thus, to the extent our decision today is inconsistent with *Thill*, we find ourselves constrained to disagree with the holding there announced.***"

Where an important question has been differently decided by two different circuits this Court will, in general, grant certiorari to resolve the conflict. See, for example, *FTC v. Flotill Products, Inc.*, 389 US 179, *Willingham v. Morgan*, 389 US 179, *US v. Donruss Co.*, 393 US 297, and *SEC v. National Securities, Inc.*, 393 US 453. The last-cited case involved the grant of a Petition for a Writ of Certiorari to determine questions with respect to the administration of the Securities Laws.

POINT THREE

THERE ARE GRAVE CONSTITUTIONAL QUESTIONS INVOLVED IN THIS APPEAL.

The determination of the Court of Appeals heavily relied upon Section 19 of the Securities and Exchange Act of 1934 where Section 19(b) provides that

> "*** The Commission is further authorized, *if after making appropriate request in writing to a national securities exchange that such exchange*

effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange [insofar as necessary or appropriate to effect such changes] in respect of such matters as [9] the fixing of reasonable rates of commission . . ." (emphasis supplied).

However this is not the manner in which the Commission proceeded. The Commission considered a mere "letter" from the Exchanges with respect to this matter, gave no notice to the Exchanges to change their rules, and conducted no adversary-type hearing with respect to such changes. Indeed, after the rates involved were "not objected to" the Commission represented to the Courts that it had no power to fix commission rates and that its "suggestions" amounted to non-reviewable determinations.

Such a construction of the law would involve an unconstitutional application of the Statute in violation of the Fifth Amendment to the Constitution of the United States. This, of course, was not the intention of Congress in enacting the Securities Acts. The Commission would have the appropriate power, to determine that Commission

Rates, in *selected cases,* were "unreasonable". However it was not given the power to permit a horizontal conspiracy with respect to fixed commission rates or to merely give the stock exchanges "letter opinions" that certain practices were to be tolerated by the Commission and, by that device, preclude Judicial Review of such determinations.

POINT FOUR

THE DETERMINATION OF THE COURT OF APPEALS IS IN CONFLICT WITH THE DETERMINATION IN THE SILVER CASE DECIDED BY THIS COURT.

This Court, in the landmark case of *Silver vs. New York Stock Exchange,* 373 US 341, rejected the contention of the New York Stock Exchange that it enjoyed a "blanket exemption" from the antitrust laws because it was a "regulated industry" subject to control by the Securities and Exchange Commission. The Court in *Silver* held that there was no such general exemption from the anti-trust laws given to the Securities industry. Indeed, this Court held on pages 359-60 of the opinion as follows:

> "* * * Since the antitrust laws serve, among other things, to protect competitive freedom, i.e., the freedom of individual business units to compete unhindered by the group action of others, it follows that the antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of exchanges which conflict with their duty to keep their

operations and those of their members honest and viable. . . ."

In the present case, it must be conceded, based upon the SEC's own position before two different courts, that it did not "fix" the commission rates involved. The removal of fixed commission rates and the permitting of such commission rates to be set by normal competitive forces is not necessary to "make the securities acts work".

It is interesting to note the subsequent history of the fixed commission rate battle since the determination of the Court of Appeals in this case. The Securities and Exchange Commission (apparently mindful of the issues in this suit) has determined, tentatively, that fixed commission rates would be phased out in April 1975 and that rates would be permitted to be set competitively after that time. In the meantime, however, the New York Stock Exchange now joined by the American Stock Exchange, has petitioned the Commission to permit a further increase in the Commission Rates to "small investors". The petition is based upon the admitted premise that the brokerage community needs more income and must be shielded from competitive forces. The Exchanges also admit that they attempted to raise commission rates to large customers and were rebuffed. Therefore they seek to raise rates to the group of the population not able to protect themselves.

The defendant exchanges have further publicly stated that they will do all that is necessary to prevent the institution of competitive commission rates in 1975 and will

petition the Securities and Exchange Commission for such relief.

POINT FIVE

THIS COURT SHOULD REVERSE THE DETERMINATION OF THE COURT OF APPEALS AND, AT THE VERY LEAST, REMAND THIS CASE FOR TRIAL.

The function of a Petition for a Writ of Certiorari is to demonstrate to the Court, the reasons why such review should be granted. The Petition generally does not include an extensive study of the law involved. However, for the information of the Court, a capsule exposition of the applicable law will be set forth.

There is no question that, if the SEC did not exist, the fixation of commission rates by the defendant Stock Exchanges coupled with the penalties imposed for violation of the fixed minimum commissions to be charged, would be *per se* violations of the anti-trust laws, Section 1 of the Sherman Act (15 USC 1) prohibits:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.* * *"

That the fixation of minimum commission rates, with penalties for non-compliance thereof, is a *per se* violation

of the anti-trust laws is clear. See, for example, *Premier Electric Construction Company vs. Miller Davis Co.*, 422 Fed. (2nd) 1132, certiorari denied 400 US 828, *Albrecht vs. Herald Co.*, 390 US 145, *US vs. General Motors Corp.*, 384 US 127, *Northern Pacific RR Co. vs. US*, 356 US 1, *U.S. vs. McKesson & Robbins, Inc.*, 351 US 305, and *Schwegmann Bros. vs. Calvert Distillers Corp.*, 341 US 384. *Schwegmann* is of importance for the proposition that a State statute cannot override the anti-trust laws.

The Securities Acts expressly permitted parties to have all rights that they previously had under other statutes and clearly there was no intention to repeal the anti-trust laws.

The challenged fixed commission rates are also a violation of Section 2 of the Sherman Act (15 USC 2) which reads in part as follows:

> "Every person who shall monopolize, or attempt to monopolize, or combine and conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States or with foreign nations, shall be guilty of a misdemeanor. * * *"

Various stock exchange rules provide for limited access to the facilities of the exchanges, prevent sharing of commissions with non-members of the exchanges, etc.

Such action has been held to be a violation of Section 2 of the Sherman Act (*US vs. National Association of Real*

Estate Boards, 339 US 485). This case is of interest in that it involved the fixation of commission rates by a trade association almost precisely what is involved in the present case.

Thus, the sole justification for anti-trust immunity on the part of the defendants lies within the ambit of the Securities Acts. However, such immunity must be given strictly in accordance with the *Silver and Thill* rationale to the effect that any rule of an exchange is immune from the anti-trust laws only is necessary to make the Securities Exchange Act work and even then only to the minimum extent necessary, even if the challenged rule has been submitted to the SEC pursuant to the Commission's rule 17a-8 or is subject to Commission action under the Securities Exchange Act. (See the 1972 "Securities Industry Study" of the Subcommittee on Commerce and Finance of the House of Representatives Committee on Interstate and Foreign Commerce.)

The above report also held as follows:

> "* * * The Subcommittee does not believe that the Congress intended in 1934 nor does it intend today that the limited review power granted to the Commission in the Securities Exchange Act should insulate the rules of national securities exchanges from antitrust scrutiny.* * *"

The 1973 Securities Industry Study of the Subcommittee on Securities of the Senate Committee on Banking, House

and Urban Affairs held as follows:

> "* * * Anti-competitive conduct of self-regulatory bodies is immune from antitrust attack only if the conduct is necessary to make the statutory scheme of regulation work and then only to the minimum extent necessary. This immunity is not increased or broadened in the event that the action in question is subject to SEC review or even if it is in fact approved by the SEC. *The SEC has no power to immunize anti-competitive self-regulatory conduct from the operations of the anti-trust laws* (See page 227 of said report) (emphasis supplied).

The report of a committee of Congress, of course, is highly significant in the determination of "legislative intent" with respect to a statutory enactment.

The Congress, at the present time, is considering various legislation with respect to the Securities Industry. However, any such legislation, which has not been passed as yet, could not, of course, relate to conduct which has previously taken place since that would constitute an "ex post facto" law in violation of the United States Constitution.

CONCLUSION

THIS COURT SHOULD GRANT CERTIORARI TO REVIEW THE QUESTIONS PRESENTED IN THIS PETITION.

Respectfully submitted,

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Appendix

OPINION OF U.S. DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK GRANTING DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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71 Civ. 1496 — Memorandum No. 40086

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTORS PROTECTIVE LEAGUE, an unincoprorated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Plaintiff.

-against-

NEW YORK STOCK EXCHANGE, INC., and MERRILL LYNCH PIERCE FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the NEW YORK STOCK EXCHANGE AND AMERICAN STOCK EXCHANGE,

Defendants.

LASKER, D.J.

In this action, brought by Richard A. Gordon, individually and as President of Independent Investors

Protective League, against the New York Stock Exchange, the American Stock Exchange ("the Exchanges") and their member firms, plaintiff alleges several violations of the Robinson-Patman Act and the Sherman Act, to the detriment of "small investors" (those ineligible for either "volume discounts" on trades of over 1,000 shares, or negotiated rates on trades above the $500,000 (now $300,000) "breakpoint").

Specifically, plaintiff attacks the Exchanges' practices of making their facilities available only to members and of limiting the number of memberships; he also alleges that members have conspired with the Exchanges to fix rates for small investors at an unreasonably high level in view of the actual cost of executing a trade; that negotiated rates and volume discounts are set at unreasonably low levels in view of the actual costs of execution; and that this scheme unlawfully discriminates against small investors. In short, plaintiff makes a number of related claims, the essence of which is a broadside attack on the present commission structure of the Exchanges.

Defendants have moved for an order dismissing the action and granting summary judgment on the grounds that the practices complained of are within the exclusive jurisdiction of the Securities and Exchange Commission, that the SEC, acting pursuant to §19(b) of the Exchange Act of 1934, 15 U.S.C. §78s(b), has been actively regulating these practices, and that, consequently, the practices are exempt from the provisions of the antitrust law so that the court is without subject matter jurisdiction.

I.

We deal first with plaintiff's related claims regarding the Exchanges' practices of limiting the number of memberships, and denying the use of their facilities to non-members unless they pay the same rate of commission charged the general public (Complaint, Paragraph 17).

As to the first claim, plaintiff lacks standing to sue since he has not met the threshold requirement of §4 of the Clayton Act: "Any person who shall be injured in his business or property by reason of any thing forbidden in the anti-trust laws may sue therefor . . ." (15 U.S.C. §15). Since it is undisputed that plaintiff has never made application for membership in either defendant Exchange, he cannot be heard to complain that memberships are arbitrarily limited. See *Billy Baxter, Inc. v. Coca-Cola Company*, 431 F.2d 183, 187 (2d Cir. 1970), *cert. denied*, 401 U.S. 923 (1971); *Data Digests, Inc. v. Standard & Poor's Corporation*, 43 F.R.D. 386, 387-8 (S.D.N.Y. 1967).

Plaintiff's second claim must also fail in view of the clear language of the Exchange Act of 1934 to the effect that non-members' access to Exchange facilities is limited. Section 3(a)(3) states:

> "The term 'member' when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as

broker, or to *make use of the facilities of an exchange for transactions thereon without payment of a fee or with the payment of a commission or fee which is less than that charged the general public,* and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of such firm." (emphasis added)

The fact that the limited membership characteristic of the Exchanges inheres in their very nature has been recognized by the Supreme Court, *Silver v. New York Stock Exchange,* 373 U.S. 341, 350-51 (1963) and this Circuit, *Robert W. Stark, Jr., Inc. v. New York Stock Exchange, Inc.*, 346 F. Supp. 217, 228 (S.D.N.Y. 1972), *aff'd per curiam,* Dkt. No. 72-1810, Slip Op. 928 (2d Cir. Aug. 28, 1972) CCH Sec. L. Rep. ¶93,607.

II.

Plaintiff's claims of price discrimination predicated upon the Robinson-Patman Act, 15 U.S.C. §13(a), are without merit. The Act requires that the alleged price discrimination be in connection with "commodities of like grade and quality". The authorities are clear that services and intangibles (such as stock trade executions) are not "commodities" within the meaning of the Act. *Columbia Broadcasting System v. Amana Refrigeration,* 295 F.2d 375 (7th Cir. 1961); *Baum v. Investors Diversified Services, Inc.*, 409 F.2d 872, 875 (7th Cir. 1969), and cases cited therein.

III.

Plaintiff's remaining claims relating to the commission rate structure of the Exchanges pose the question whether the Exchanges, subject to SEC supervision, can fix commission rates without incurring Sherman Act liability. It is, of course, conceded by defendants that any such immunity must be provided, if at all, by the Securities & Exchange Act of 1934.

The question of the extent to which the 1934 Act exempts the Exchanges from the anti-trust laws has not been considered in this Circuit since *Silver v. New York Stock Exchange,* 373 U.S. 341 (1963). That case involved a non-member broker who had secured private wire connections with certain New York Stock Exchange firms. The Exchange had approved Silver's connections on a temporary basis, but subsequently ordered them disconnected without notice or hearing. After observing that the Exchange's actions, absent justification from the Exchange Act, would have constituted a *per se* violation of the Sherman Act, the *Silver* court sought to reconcile the "antitrust aim of eliminating restraints on competition with the effective operation of a public policy contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." (*Silver* at 349.)

Noting that the Exchange Act does not give the commission jurisdiction to review *particular instances of enforcement* of Exchange rules, the Court stated that

consequently the question of antitrust exemption did "not involve any problem of conflict or co-extensiveness of coverage with the agency's regulatory power," and that court review of the circumstances there presented "is therefore not at all incompatible with the fulfillment of the aims of the [Act]". (*Silver* at 359.) The court concluded that the severance of the private wires occurred under "totally unjustifiable circumstances" (*Silver* at 361) and that no policy of the Exchange Act was served by denial of notice and opportunity for hearing.

In so holding, however, *Silver* did not specify the circumstances in which a federal district court must decline jurisdiction to avoid a possible conflict with the commission, and specifically reserved decision on the possible anti-trust immunity of exchanges where "review of exchange self-regulation [is] provided through a vehicle other than the antitrust laws. . . ." (p. 360).

We hold that this court lacks jurisdiction to entertain an anti-trust attack on the commission structure of the Exchanges, since the fixing of commissions falls squarely within the congressional policy of exchange self-regulation embodied in the 1934 Act. Since the Act expressly directs the SEC to supervise the "fixing of reasonable rates of commission" (§19(b)(9)), we believe this is the "different case," on which *Silver* reserved decision, where review of exchange self-regulation is available "through a vehicle other than the antitrust laws" (*Silver*, p. 360).

In so holding, we are in disagreement with the Seventh Circuit, See *Thill Securities Corp. v. New York Stock*

Exchange, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971), a decision to which we return later on.

We believe that while *Silver* quite properly punctured the umbrella of anti-trust immunity claimed by the Exchange, it did not intend Congress' unique self-regulatory scheme to be totally dampened by the continuous interference of an anti-trust court. We read *Silver* as holding that certain limited areas of Exchange regulation—such as potentially anti-competitive and arbitrary conduct directed at non-members—are properly interfered with by a reviewing court since the Act purports to regulate only the conduct of registered exchanges (and their members) with regard to the public, rather than the entire securities business. But *Silver* also contemplates a certain zone of anti-trust immunity in the regulatory process where there is little threat of such arbitrary and discriminatory activity.

Without venturing to describe the full contours of this immunity, we believe that the Exchange Act, as construed by *Silver*, left the power to fix commission rates within the exclusive jurisdiction of the Exchange, subject to commission supervision.

This construction finds ample support in the language of *Silver*. The court describes the Exchanges as "by their nature bodies with a limited number of members" (p. 350) with a "federally mandated duty of self-policing" (p. 352).

> "The pattern of governmental entry . . . was by no means one of total displacement of the exchanges' traditional process of self-

> regulation . . . Thus the Senate Committee Report stressed that the 'initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so." S. Rep. No. 792 [73d Cong., 2d Session (1934)] at 13.

The court continues at (360-61) that:

> "The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act. Without the oversight of the Commission to elaborate from time to time on the propriety of various acts of self-regulation, the Exchange is left without guidance and without warning as to what regulative action would be viewed as excessive by an antitrust court. . . . But, under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act."

The clear import of this language is that the Exchange Act sanctions certain "anti-competitive" features of the

Exchanges so long as they further the policy of self-regulation and are subject to Commission supervision, guided by the "rule of reason". Indeed, we note that *Silver* sets out at some length (p. 354-6, n. 9) the welter of Exchange rules restricting members' relations with non-members, which were there in issue.

In holding that the *manner* of *enforcing* these rules was illegal, *Silver* never intimates that the rules themselves are subject to anti-trust attack, and indeed recognizes the necessity for them (p. 354-6).

The facial language of the Exchange Act gives the Exchange and the Commission the power to "fix" commission rates. Section 6(d) of the Act requires that registered exchange adopt rules "just and adequate to insure fair dealing and to protect investors;" that is, §6(d) mandates self-regulation. As *Silver* observes "[t]he general dimensions of the duty of self-regulation are suggested by §19(b) of the Act, 15 U.S.C. §78s(b), which gives the Commission power to order changes in exchange rules respecting a number of subjects . . ." (p. 352). §19(b) recites:

> "Sec. 19. *** The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has

not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as *** (9) *the fixing of reasonable rates of commission, interest, listing, and other charges;* (10) *minimum units of trading . . . ;* and (13) similar matters." (emphasis added)

We recognize that the legislative history of the 1934 Act is, perhaps typically, ambiguous as to Congress' intent regarding the Exchanges' long-standing practice of fixing commission rates. As Professor Baxter of Stanford Law School has noted:

> "[t]he attention of Congress in 1934 was focused on problems of dishonesty, manipulation, and solvency, and . . . no coherent congressional purpose was articulated concerning the problems of intra-industry competitive structure." Baxter, New York Stock Exchange Fixed Commission Rates: A Private Cartel Goes Public, 22 Stan. L. Rev. 675, 685 (1970).

However, Congress clearly was aware of the Exchanges' rate-fixing practices, since both House and Senate debates on the Act specifically refer to the fixing of commissions. See, e.g., 78 Cong. Rec. 8087, 8092, 8490, 8493-94 (1934).[1]

Nevertheless, however unclear the Congressional debate in 1934 may be as to the permissibility of fixing commissions, we believe the history of Exchange rate-regulation since the passage of the Act is entitled to substantial weight. As to the proper construction of the Act, we cannot overlook the fact that Exchange regulation of fixed commissions has existed virtually unchallenged for nearly 40 years since the passage of the Act.

In the case most in point, *Kaplan v. Lehman Brothers,* 250 F. Supp. 562 (N.D. Ill. 1966), *aff'd* 371 F.2d 409 (7th Cir. 1967), shareholders of five mutual funds brought a treble damage action against the New York Stock Exchange and several stock brokerage firms claiming that the fixing of minimum commissions was a *per se* violation of the Sherman Act. The Court of Appeals affirmed an award of summary judgment for the defendants since, as the trial court noted, plaintiff's *per se* allegation was defective in light of the weighing process required under *Silver.* Though *Kaplan* is distinguishable on its facts, the court there recognized the possibility of a conflict of jurisdiction with the Commission. Its comments are applicable here since the gist of the complaint in both cases is that plaintiff paid higher rates than would have obtained in the absence of Exchange rate-fixing.

> "The plaintiffs have complained of the rates because they are fixed. If they had complained instead that the rates were too high, they would find no support in the antitrust laws. The remedy for a level of rates which is unreasonably high rests with the SEC. Ratemaking is a matter for which

the courts are ill-equipped and accordingly a matter traditionally committed to an administrative agency. [citation omitted]. The SEC since its establishment has exercised this power of review over Exchange rates of commission, and it has inaugurated a regular system of reporting from Exchange members to furnish the necessary information.

. . . To leave the determination of reasonableness to the prospective decisions of the agency which is especially qualified and responsible for the general supervision of the industry will assure the intention of Congress as well as the interests of the public." (250 F. Supp. at 566).

We note that, beginning with the 1963 *Special Study of The Securities Markets,* the SEC and the Exchanges have undertaken intensive examination of Exchange commission structures and related matters. In 1968, the SEC initiated public hearings on the commission rate structure.

Certain rate adjustments, such as the volume discount, and the interim charge, and experiments with negotiated commissions have resulted from these activities. Most significant, the SEC recently announced, in its Release 10383 (September 11, 1973), its intention to terminate the Exchange practice of fixing minimum commissions on all securities transactions after April 30, 1975, unless the Exchange in the meantime alters its rules to the same effect. It is fair to infer that the SEC is continuing to

exercise its jurisdiction actively over rate-setting, pursuant to §19(b)(9) of the Act.

Moreover, recent developments in Congress regarding the commission structure support the holding here. The Senate recently rejected amendments to the 1934 Act which would have mandated the elimination of fixed commissions within two years. See 119 Cong. Record, S11385-6, June 18, 1973. It is reasonable to infer from the proposal of these amendments that Congress did not believe fixed commissions were already illegal under the anti-trust laws, and, of course, the rejection of the amendments suggests that Congress does not now regard fixed rates as offensive to the Exchange Act or the anti-trust laws.

Finally, we come to the recent decision in *Thill Securities Corp. v. New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971).

In *Thill,* a non-member broker-dealer attacked the anti-rebate rule of the New York Stock Exchange as violative of the Sherman Act. The Seventh Circuit reversed the grant of summary judgment in favor of the New York Stock Exchange predicated on a claim of immunity, and remanded the case to the trial court for further evidence on the effects of the anti-competitive acts complained of, the extent to which the rule was subject to actual review by the SEC, and the extent to which the anti-rebate rule was "necessary to make the Securities Exchange Act work." (*Thill,* at 270).

We believe that *Thill* is distinguishable from our case. First, the Act contains no specific directive to the SEC to supervise member-non-member relations; second, there

was before the court no record of active SEC supervision in the area; third, the court thought the power to refuse to share commissions with non-members was a "weapon that can be used to injure a particular competitor" (p. 270) and the plaintiff had alleged that the anti-rebate rule had in fact been unevenly applied.

Indeed, in distinguishing *Kaplan, supra*—another Seventh Circuit case—the *Thill* court placed considerable weight on the distinction it perceived between the non-discriminatory application of fixed commission rates (at issue in *Kaplan*) uniformly charged to the *public,* and the application of rules governing rebates with non-member broker-dealers (p. 270).

We must add, if it is not already clear, that if *Thill* is to be read as holding that an anti-trust court has concurrent jurisdiction with the SEC over *all* potentially anti-competitive practices and rules, we disagree.

For the foregoing reasons, defendants' motion for summary judgment is granted.

In view of our decision here, we do not consider plaintiff's motion for a class action determination.

It is so ordered.

Dated: New York, New York
December 3rd, 1973.

MORRIS E. LASKER
U.S.D.J.

FOOTNOTE

In *Thill Securities Corp., v. New York Stock Exchange,* Civ. 63-C-264 (E.D. Wisc. 1973), the post-trial brief of the United States, as intervenor, arguing the *illegality* of fixed commission, and the anti-rebate rule concedes that "it cannot be said that Congress intended to outlaw fixed minimum commissions in passing the 1934 Act." (Post-trial brief at pp. 8-9).

OPINION OF UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AFFIRMING OPINION OF DISTRICT COURT

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1045—September Term, 1973.

(Argued June 5, 1974 Decided June 28, 1974.)

Docket No. 74-1043

RICHARD A. GORDON, individually and as President of Independent Investors Protective League, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Plaintiff-Appellant,

v.

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC. and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Defendants-Appellees.

Before:

KAUFMAN, *Chief Judge,*
MANSFIELD and MULLIGAN, *Circuit Judges.*

Appeal from an order entered in the United States District Court for the Southern District of New York, Morris E. Lasker, *Judge,* granting summary judgment and dismissing complaint principally alleging that the fixing of stock exchange commission rates violates the antitrust laws.

Affirmed.

I. Walton Bader, New York, New York (Bader and Bader, New York, New York, on the brief), *for Appellant.*

William E. Jackson, New York, New York (Milbank, Tweed, Hadley & McCloy, Lord, Day & Lord, Brown, Wood, Fuller, Caldwell & Ivey, New York, New York, on the brief; Isaac Shapiro, Mark L. Davidson, John J. Loflin, James B. May, New York, New York, of counsel), *for Appellees.*

Seymour H. Dussman, Attorney, Department of Justice, Washington, D.C. (Thomas E. Kauper, Assistant Attorney General, on the brief), as *Amicus Curiae urging reversal.*

Lawrence E. Nerheim, General Counsel, Securities Exchange Commission, Washington, D.C. (Walter P. North, Associate General Counsel, Frederic T. Spindel, Special Counsel, Theodore L. Freedman, Attorney, on the brief), as *Amicus Curiae urging affirmance.*

Kaufman, *Chief Judge:*

Whether the minimum rate structure presently employed by the nation's stock exchanges enjoys immunity from attack under the antitrust laws is a question of such importance that we need not belabor its significance. The Supreme Court in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963), although subjecting the application of an exchange rule to antitrust scrutiny, acknowledged that if there were Securities Exchange Commission [SEC] jurisdiction to review a challenged rule, a different case would arise con-

cerning antitrust exemption. We are here presented with that different case.

The complaint itself provides all the facts necessary for our disposition. Richard A. Gordon brought this private antitrust action on April 2, 1971, on his own behalf and for a purported class of small investors, against the New York Stock Exchange, Inc. [NYSE], the American Stock Exchange, Inc. [Amex], and two representative member firms of the exchanges,[1] alleging that the exchanges' fixed minimum commission system violated the Sherman Act, 15 U.S.C. §§ 1 and 2 (1970), and the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970). More specifically, we read Gordon's complaint to have alleged: (1) that the exchange rules providing for a volume discount from the minimum commission rate in the case of large transactions, together with negotiated rates only on portions of orders in excess of $500,000,[2] and the interim surcharge on transactions involving less than 1000 shares,[3] amounted to a system of price discrimination in violation of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970),[4] and the Sherman Act, 15 U.S.C. §§ 1, 2 (1970); and (2) that the fixed commissions charged those unable to avail themselves of negotiated rates constituted a scheme of price-fixing, contrary to the provisions of the Sherman Act, 15 U.S.C. §§ 1, 2 (1970).[5]

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1 Merrill, Lynch, Pierce, Fenner & Smith, and Bache & Co., Inc.

2 NYSE Const. Art. XV, § 2 (1971); *subsequently amended;* Amex. Const., Art. VI, § 2 (1971), *subsequently amended.*

3 NYSE Rule 383 (1971), *repealed* April 1, 1974; Amex Rule 396 (1971), *amended* April 1, 1972.

4 Gordon also claimed that the volume discounts were "unreasonably low prices for the purpose of destroying competition or eliminating a competitor," in violation of 15 U.S.C. § 13a (1970). Although the district court made no finding in this regard, plaintiff does not press the point on appeal.

5 The complaint also challenged rules which limited exchange membership, and which denied discounted commission rates to nonmember

Without reaching the merits of Gordon's principal claims, the district court found the challenged practice of fixing commission rates not within the jurisdiction of an antitrust court since judicial oversight of this particular aspect of exchange self-regulation had been displaced by the review power vested in the SEC under § 19(b) of the Securities Exchange Act of 1934 [1934 Act], 15 U.S.C. § 78s(b) (1970). Accordingly, the district court granted the defendants' motion for summary judgment, and dismissed the complaint.[6] For the reasons set forth below, we agree.

Since Gordon's other claims are essentially frivolous,[7] we turn directly to his principal allegation that the exchange practice of fixing commission rates violated the Sherman Act. Any analysis of the interrelation of the antitrust laws and the system of supervised exchange self-regulation embodied in the 1934 Act must begin with *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). The Court was there asked to decide whether the NYSE's

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brokers who used exchange facilities. The district court concluded that these claims were frivolous. We agree, since § 3(a)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(3) (1970), clearly contemplates limitations on both exchange membership and nonmember access to exchange facilities.

6 Because the district court considered affidavits and exhibits annexed as well as the pleadings, it properly concluded that the motion to dismiss should be treated as one for summary judgment. Rule 12(b), F.R. Civ. P.

7 We agree with the district court that there is no precedent for the assertion that brokerage services are "commodities" within the meaning of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970).

Gordon raises on appeal for the first time the claim that the combination of surcharges, volume discounts, and negotiated rates violates 15 U.S.C. § 13(c) (1970), as an allowance or commission not granted for services rendered. Although we decline to entertain the claim because it was not raised in the district court, we note that § 13(c) proscribes such practices only "in connection with the sale or purchase of goods, wares, or merchandise . . . ."

enforcement of an exchange rule without notice or hearing, resulting in the removal of a nonmember's private telegraph wires from member offices—concededly a group boycott—was subject to antitrust scrutiny. Seeking to achieve the requisite accommodation between the antitrust laws and the 1934 Act's policy of exchange self-regulation, Mr. Justice Goldberg, speaking for a majority of the Court, formulated the following test:

> Repeal [of the antitrust laws] is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary.

373 U.S. at 357.

In *Silver*, the Court concluded that exercise of its antitrust jurisdiction was proper for two reasons. Because there was no possibility of SEC review of the challenged act—disconnection of Silver's wires to member offices—assertion of judicial oversight would have resulted in no conflict, between agency and court, rendering cumbersome and inconsistent the system of administrative regulation. 373 U.S. at 358. Moreover, denial of antitrust jurisdiction on the facts presented in *Silver* would have left no governmental body to perform the antitrust function of preventing an injury to competition which could not be justified as furthering legitimate self-regulatory ends. *Id.* at 358-61. Though the Court hinted that some breathing space should be left the exchange for unsupervised self-regulation, if found inexcusable the failure to provide the procedural safeguards of notice and hearing. *Id.* at 361-67.

The instant case, of course, is *toto caelo* different from *Silver*, for there is here governmental oversight of the fixing of commission rates, vested expressly in the SEC pursuant to § 19(b)(9) of the 1934 Act, 15 U.S.C. § 78s(b)(9)

(1970). And, as we have indicated, the *Silver* Court recognized that a "different case" would be posed if the exchange practice allegedly violative of the antitrust laws were subject to control by the SEC. Although the *Silver* rationale might well authorize us to ground our holding here on the existence of SEC review power, we do not rely upon that authority alone to support a finding of antitrust immunity. Rather, we are of the view that both the language and the history of the 1934 Act, together with the sound policy behind supervised exchange self-regulation, mandate the conclusion that Congress intended to exempt from the antitrust laws the exchange practice of fixing commission rates.

Section 19(b) of the 1934 Act states, in pertinent part:

> The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as . . . (9) the fixing of reasonable rates of commission, interest, listing, and other charges . . .

It is clear from this language that the "congressional aim in supervised self-regulation is to insure fair dealing and to protect investors from harmful or unfair trade

practices," *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, 130 (1973). It is equally plain that Congress considered the "fixing of reasonable rates of commission" to be essential to meeting these goals, for it listed this factor explicitly among the twelve items so denominated. Finally, and most importantly for this jurisdictional dispute between an antitrust court and the SEC, Congress vested in the Commission the power to determine whether changes are "necessary" in the exchanges' rate-fixing practices to assure fulfillment of the goals of the Act. Accordingly, Congress defined in § 19(b) those matters fundamental to achieving "the aims of the Securities Exchange Act," *Silver* v. *New York Stock Exchange,* 373 U.S. at 361, and accorded the SEC the authority to make whatever changes respecting those matters are "necessary or appropriate" (§ 19(b)) to effectuate those aims —*i.e.,* in the terms of the *Silver* test, "necessary to make the Securities Exchange Act work." 373 U.S. at 357.

If the discussion in *Silver* of a core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws, is to be given any meaningful application, we are of the view that it must have reference to the practices enumerated in § 19(b), and in this instance to the fixing of reasonable rates of commission. The Supreme Court also recognized in *Silver* that the exercise of antitrust jurisdiction, where it conflicted with a power of review expressly delegated to the SEC, could render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the 1934 Act. 373 U.S. at 358-61. Frustration of those aims would be the inevitable consequence of duplicative or inconsistent standards announced contemporaneously by courts and Commission.

That Congress intended Commission-supervised exchange self-regulation to be of central importance in the

scheme of the 1934 Act is emphasized by the legislative history of the Act. Both House and Senate reports stress the broad responsibility left with the exchanges to administer their own affairs. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 13 (1934). The grant of this unique self-regulatory power, however, was conditioned upon the creation of the SEC, invested with broad discretionary powers equal to the complex and changing nature of the problems arising in the securities industry. *Cf.* H.R. Rep. No. 1383 at 6-7. Rather than charge the Commission with oversight of specific instances of abuse, Congress authorized it to condition an exchange's right to register upon its enactment of rules "just and adequate to insure fair dealing and to protect investors." 15 U.S.C. § 78f(d) (1970). And as to several specific matters inextricably linked with "fair dealing" and "protection of investors" from harmful or unfair trade practices, the Commission was empowered by § 19(b) to order exchanges to make such amendments in their rules as the Commission found necessary to carry out the purposes of the Act.

Yet the legislative history of the Act does not simply indicate the central significance of supervised self-regulation in effectuating the purposes of the Act. Concerning the practices here challenged, we find most persuasive Congress's manifest recognition of the Commission's competence to serve the necessary antitrust objective of preserving competition, by delegating to it control over practices which, but for § 19(b) of the 1934 Act, would be per se violations of the antitrust laws. Those familiar with the development of antitrust law know that seven years before the Securities Exchange Act was passed, the Supreme Court decided that price-fixing was a per se violation of the Sherman Act. *United States* v. *Trenton Potteries Co.*, 273 U.S.

392 (1927). Despite this clear holding, the 1934 Act explicitly provides for "the *fixing* of reasonable rates of commission, interest, listing, and other charges" [emphasis added]. 15 U.S.C. § 78s(b)(9) (1970). Reference to the Senate hearings dispels any doubt on this score, for they make plain the congressional awareness that this provision "would permit the Commission to fix rates." *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st and 2d Sess., pt. 16, at 7705 (1934) (statement of Samuel Untermyer). Moreover, the practice in the securities field of industry-wide agreement on minimum fees—dating back to 1792, *see* SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 295 (1963)—was repeatedly acknowledged both in committee hearings, *see Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 13, at 6075, 6080-81 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess., at 423-34 (1934), and in the debates on the Act, *see, e.g.*, 78 Cong. Rec. 8087, 8091-92, 8490, 8493-94 (1934).

We draw two conclusions from this delegation of power over exchange commission rates. By permitting so potentially harmful a practice as rate-fixing, Congress recognized that the exchange commission system bore crucially upon achievement of the goals of the 1934 Act. Further, by placing in the hands of the SEC the regulation of rate-fixing—a practice the effects of which the Supreme Court acknowledged its inability to assess, *see United States* v. *Trenton Potteries, supra*, 273 U.S. at 398—Congress made clear its judgment of the Commission's competence to assume the central role in assuring investor protection and exchange fair dealing.

Exemption from the antitrust laws with regard to the fixing of minimum rates of commission is not only mandated by both the language and the legislative history of the 1934 Act, and in particular § 19(b)(9), but is grounded as well in sound policy considerations governing regulation of the securities industry. Of principal concern is the danger, clearly contemplated by *Silver*, 373 U.S. at 358, that courts and the SEC would subject exchanges to repetitive or conflicting standards. There is little question but that the commission rate structure is the keystone of the economic viability of the brokerage industry, and a matter of vital importance to individual investors as well. Steering effectively between the often competing interests of "seller" and "buyer"—reducing the barriers to investor trading, while at the same time assuring a return sufficient to preserve brokerage capacity—becomes far too hazardous with two hands on the tiller.

Nor are the hazards of repetition and conflict in this case a matter of mere speculation, as a review of the wide-reaching and systematic character of recent SEC action regarding rate regulation makes evident. In 1963, following the congressional mandate embodied in 15 U.S.C. § 78s (d), the SEC published its extensive Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963), dealing among other matters with the practice of fixing stock exchange commission rates. Recent Commission action with regard to the particular practices challenged by Gordon began in 1959, with a request to the NYSE to study the possible introduction of a volume discount. *See* SEC Securities Exchange Act Release No. 5889 (Feb. 20, 1959). Comment was requested on both NYSE and SEC proposals on January 26, 1968. SEC Securities Exchange Act Release No. 8239 (Jan. 26, 1968). On May 28, 1968, the NYSE was asked either to implement a suggested commission schedule incorporating volume discounts for

round lot portions over 400 shares, or to eliminate minimum commissions on portions of orders in excess of $50,000, before September 15 of the same year. Public hearings also were commenced on May 28, 1968, to determine "changes in the present commission rate structure . . . required to benefit the investing public." SEC Securities Exchange Act Release No. 8324 (May 28, 1968). The same release requested that other exchanges make "appropriate" changes similar to those demanded of the NYSE. The Commission thereafter notified the NYSE that the requirements of Release No. 8324 would be satisfied by provision for a volume discount on orders in excess of 1000 shares, Letter of Manuel F. Cohen to Robert W. Haack (August 30, 1968), and on September 4, 1968, it extended the mandated effective date to December 5, 1968. SEC Securities Exchange Act Release No. 8399 (Sept. 4, 1968).

Commission approval was given on August 2, 1970, for the interim surcharge challenged by Gordon, in order "to provide emergency financial relief while more fundamental alterations of the existing rate structure can be considered." Approval was subject to the understanding that the surcharge would expire after 90 days, and that the NYSE would restore full brokerage services for small investors and remove transaction size and other limitations on such accounts. Letter of Hamer H. Budge to Robert W. Haack, April 2, 1970. Approval was given on similar conditions to the Amex proposed rule 396, requesting a like interim surcharge. Letter of Irving M. Pollack to Ralph S. Saul, April 10, 1970. The terms of the surcharges were thereafter extended, SEC Securities Exchange Act Release 8923 (July 2, 1970), and expired in March (NYSE) and April (Amex) of 1972.

The recent SEC program which aims at gradual introduction of negotiated rates strongly enforces our view

that it would be unwise for a court to interfere under the antitrust laws. Although SEC Securities Exchange Act Release No. 8324 (May 28, 1968) contemplated the introduction of negotiated rates as an alternative to volume discounts, the Commission determined by October 22, 1970, that fixed charges on portions of orders in excess of $100,000 were—even when joined with volume discounts—neither necessary nor appropriate to achieving the purposes of the 1934 Act. Letter of Hamer H. Budge to Robert W. Haack, October 22, 1970; SEC Securities Exchange Act Release No. 9007 (Oct. 22, 1970). The Commission subsequently indicated that a $500,000 "breakpoint" would be acceptable, Letter of Richard B. Smith to Robert W. Haack, February 10, 1971; SEC Securities Exchange Act Release No. 9105 (March 11, 1971), and sent to the other exchanges copies of its correspondence with the NYSE regarding negotiated rates for their "appropriate consideration." Letter of Irving M. Pollack to the presidents of the American, Boston, Cincinnati, Detroit, Midwest, National, Pacific Coast, Philadelphia-Baltimore-Washington, Salt Lake, and Spokane Stock Exchanges, March 17, 1971. In its Statement on the Future Structure of the Securities Markets (Feb. 2, 1972), issued subsequent to the initiation of Gordon's lawsuit, the Commission announced its conclusion, grounded on the results of monitoring undertaken concurrently by the SEC and the exchanges, that a reduction in the breakpoint to $300,000 was appropriate, and commanded its implementation by April of 1972. Not long thereafter, SEC Securities Exchange Act Release No. 10383 (Sept. 11, 1973) decreed the end of all fixed commission rates by April 30, 1975. As a further step in the process of gradual abandonment, SEC Securities Exchange Act Release No. 10560 (Dec. 14, 1973) requested the immediate introduction of limited

price competition in transactions falling below the current breakpoint.

The Commission's program of measured introduction of negotiated rates has been carefully gauged to avoid undesirable side-effects on both the industry and the investing public. The Statement on the Future Structure of the Securities Markets, 15, cautions:

> We must bear in mind . . . that we are dealing with an industry which has operated under fixed commission rates for a very long time. It is necessary to measure the effect of competitively determined commissions very carefully on a step by step basis.

We are told, for example, that among the consequences certain to result from the introduction of negotiated rates across the boards is the failure of a number of inefficient brokerage firms. Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stan. L. Rev. 675, 699 (1970). The SEC study revealed that the exchanges have operated for a long time under cartelized commission rates, which exceed those which would have been charged by firms of efficient scale. Thus, firms too small and inefficient to survive in a competitive market have so far been sheltered. Introduction of negotiated rates across the entire range of trades would, it is thought, cause many of these firms to go under. Baxter, *supra*, 22 Stan. L. Rev. at 699. Much of the damage resulting from such attrition would be borne by the investing public, to whom failing member firms would be indebted in the form of credit balances. Measured withdrawal could avoid the loss of those investor funds by allowing failing brokers to "exit by orderly merger or liquidation rather than by bankruptcy." Note, *Fixed Brokerage Commissions: An Antitrust Anal-*

ysis After the Introduction of Competitive Rates on Trades Exceeding $500,000, 85 Harv. L. Rev. 794, 811 (1972).

We have recounted at such length the Commission's actions on brokerage rate changes not solely to demonstrate the extraordinarily active surveillance by the Commission, in accordance with Congress's expressed declaration, nor even to establish that the invocation of antitrust jurisdiction would result in repetition of and conflict with SEC action. Of greater importance, it seems to us, is the reminder it offers that when something as crucial to the survival of the securities industry as its very ancient rate structure is at stake, diagnoses and changes must come from an agency with the Commission's expertise. The wisdom of the SEC's actions is, of course, not before us. We stress only that it is clear that, with respect to the fixing of commission rates, the process of administrative review in the first instance is far superior to judicial review.[8]

That Congress recognized agency superiority in this regard should not, moreover, come as a great surprise, for the courts themselves, by the time of the 1934 Act's passage, had admitted as much in abandoning the rule of reason approach to price-fixing. Indeed, the adoption of a standard of per se illegality in *Trenton Potteries* was thought necessary by the Supreme Court to relieve the

8 By this we do not intend to imply that withdrawal of antitrust jurisdiction is based on the SEC's "primary" jurisdiction over the practices challenged by Gordon. *Cf. Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264, 276-77 (7th Cir. 1970) (Swygert, *J.*, concurring). As our earlier discussion of the language and history of the 1934 Act indicates, we are of the view that Congress intended to exempt commission rate-fixing from the operation of the antitrust laws, and consequently deprived the courts of even "secondary" jurisdiction to entertain Sherman Act claims like that which Gordon asserts. Judicial review of SEC action would, however, be proper, either under the Administrative Procedure Act, 5 U.S.C. §§ 702, 704 (1970), or pursuant to the provisions of the 1934 Act, 15 U.S.C. § 78y (1970).

judiciary of the need to determine the reasonableness of prices set by horizontal agreement. The Court there stated:

> In the absence of express legislation requiring it, we should hesitate to adopt a construction [of the Sherman Act] making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies.

United States v. *Trenton Potteries,* 273 U.S. 392, 398 (1927). Such questions as the effect of fixed commission rates on trading volume and broker solvency, or the effect of competition on and the necessity for exchange membership, are not of the sort which courts can answer as well as the SEC. The statutory scheme exhibits congressional confidence that the Commission will be more capable of resolving problems of this nature.

We are not unmindful of the Seventh Circuit's decision in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), heavily relied upon by Gordon and the Department of Justice as amicus curiae for appellant.[9] The claim there presented against the NYSE's anti-rebate rule is of a different character from Gordon's challenge to rate-fixing practices. For, as the *Thill* court stated, there was "no evidence as to the extent to which the challenged rule is subject to actual review by the SEC . . ." 433 F.2d at 270. Moreover, the anti-rebate practice, not specified in any of the twelve subsections of § 19(b), may not be within that core of antitrust immunity to which we have referred. But it is a fact that at the time *Thill* was decided, the SEC was conducting hearings into,

9 The SEC has also filed a brief as amicus curiae for the appellees.

among other matters, the "economic access to exchange markets by nonmembers broker-dealers . . ." SEC Securities Exchange Act Release No. 8324 (May 28, 1968). And it would be difficult to maintain that the effect of the anti-rebate rule on investor protection, fair dealing in securities, or fair administration of an exchange is in any significant respect different from the practice of commission rate-fixing.[10] *See* Note, *Antitrust Laws and the Securities Exchanges*, 66 Nw. U.L. Rev. 100, 106 n. 40 (1971). Thus, to the extent our decision today is inconsistent with *Thill*, we find ourselves constrained to disagree with the holding there announced.[11]

We emphasize that the conclusion we reach today by no means implies that Gordon at no time may have access to the courts. After Commission action, judicial review of its decision is proper pursuant to the provisions of the Ad-

10 As such, it would appropriately fall within the rule which we today announce, under the language of § 19(b)(13), 15 U.S.C. § 78s(b)(13) (1970) ("similar matters").

11 Judge Campbell in *Thill* relied heavily upon *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963) for the proposition that implied exemption from the antitrust laws was *a fortiori* improper on the facts before the court. 433 F.2d at 272. In *Philadelphia National Bank* the Court held that, despite the congressionally required approval of the Comptroller of the Currency, pursuant to the Bank Merger Act of 1960, 12 U.S.C. § 1828 (1970), a merger between the Philadelphia National Bank and Girard banks remained subject to antitrust action by the Department of Justice.

Although we are not unmindful of the disfavor with which antitrust exemption is generally regarded, *see, e.g., California* v. *Federal Power Commission*, 369 U.S. 482 (1962), we perceive significant differences between *Philadelphia National Bank* and the case which we today decide. We note that the history of the Bank Merger Act evidenced a congressional intent not to immunize bank mergers from at least Sherman Act attack, *see* 374 U.S. at 352, whereas the 1934 Act entrusts the SEC with supervision of rate-fixing, a practice which outside the confines of the 1934 Act is a per se violation of the Sherman Act. *Cf. Silver* v. *New York Stock Exchange*, 373 U.S. at 347-49 (recognizing that a group boycott carried out within the framework of the 1934 Act is not a per se antitrust violation).

ministrative Procedure Act, 5 U.S.C. §§ 702, 704 (1970), *see Independent Broker-Dealers' Trade Association* v. *SEC*, 442 F.2d 132 (D.C. Cir.), *cert. denied*, 404 U.S. 828 (1970), and, in the case of Commission orders, under the provisions of the 1934 Act, 15 U.S.C. § 78y (1970). On such review, a court is competent to consider, in accordance with standards appropriate for review of agency action, *see* Administrative Procedure Act § 10(e), 5 U.S.C. § 706 (1970), the weight given by the Commission to competitive factors in achieving the goals of the 1934 Act.

For the reasons stated, we affirm the district court's grant of summary judgment and dismissal of Gordon's claim.

Affirmed.

Supreme Court, U. S.
FILED
JAN 2 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

against

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

Appendix

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DOCKET ENTRIES

RICHARD A. GORDON INDIVIDUALLY, ETC. VS. N.Y. STOCK EXCHANGE INC. ET-AL

1 or 2-71—Filed Complaint. Issued Summons.

4-30-71—Filed Stipulation and order extending all defendants time to answer complaint to 6-14-71. So ordered. Motley, J.

6-21-71—Filed stip and order that the time for defts' to answer complaint is ext. from 6-14-71 to 7-20-71 and the time for pltff. to move, as to whether the action is to be maintained as a class action and, if so, the membership of the class, is ext. from 6-1-71 to 7-20-71. So ordered, Gurfein, J.

7-7-71—Filed Affidavit of John E. Lawler in opposition to plaintiff's motion for defendant judgment.

7-7-71—Filed Answers of Defendants Tokyo Shipping Co. Ltd. and Gannet Freighting, Inc. to Plaintiff's Interrogatories.

7-20-71—Filed stipulation and order extending defendants time to answer complaint to 9-20-71; further stipulated that the plaintiff's time to move for a determination under Rule 23(c)(1) is extended to 9-20-71. So ordered. Frankel, J.

8-24-71—Filed summons with marshal's ret. SERVED: Merrill, Lynch, Pierce, Fenner & Smith, Inc. on 4/12/71. Bache & Co. Inc. by Melvyn J. Falis on 4/8/71. American Stock Exchange by H. Vernon Lee, Jr. on 4/22/71. New York Stock Exchange by Richard Drew on 4/12/71.

1-26-72—Filed Stip. & Order extending time to answer to 3/20/72.

3-20-72—Filed Stip. & Order extending time to answer to 5-22-72, etc. So Ordered Metzner J.

3-24-72—Filed Defendant Merrill Lynch, Pierce, Fenner & Smith Inc. Change of address.

5-23-72—filed stipulation and order extending defendants time to answer complaint to 7-21-72; further stipulated that the plaintiff's time to move for class action determination is extended to 7-21-72. So ordered. Frankel, J.

7-24-72—Filed Stipulation & Order that time for defendants to answer re: complaint is extended to September 21, 1972. Brieant J.

8-22-72—Filed stipulation and order extending defendants time to answer complaint to 9-28-72; further stipulated that the time to move for a determination as to class action is also extended to 9-28-72. So ordered. Lasker, J.

9-28-72—Filed ANSWER of Merrill, Lynch, Pierce, Fenner & Smith to complaint.

9-28-72—Filed ANSWER of New York Stock Exchange Inc. to complaint.

10-2-72—Filed Notice of Motion for Class Action Determination Ret. before Lasker, J. ROOM 2903 on 10-20-72 at 10 AM.

10-2-72—Filed Memorandum in support of motion for class action determination.

10-3-72—Filed ANSWER of American Stock Exchange Inc. to complaint.

10-19-72—Filed Stip. & Order that return date for motion re: class action determination is adj. from 10-20-72 to 11-17-72. The depositions of defendants are adj. without a date subject to fixation of new times on five days' notice. So Ordered—Lasker J.

9-1-72—Filed stipulation and order that counsel of defendant American Stock Exchange Messrs. Polk, & Wardell be replaced by Lord, Day & Lord. So O ered Lasker J.

11-16-72—Filed stipulation and order adjourning plaintiff's motion for class action determination now ret. 11-17-72 to 12-15-72. etc. So ordered. Lasker, J.

11-30-72—Filed stipulation and order adjourning plaintiff's motion for a determination of class action to 12-29-72, etc. So ordered. Lasker, J.

12-4-72—Filed Defendants' Affidavits in opposition to plaintiff's motion for class action determination.

12-4-72—Filed Affidavit of Isaac Shapiro in opposition to plaintiff's motion.

TO: CLERK OF UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

CONTINUATION OF DOCKET ENTRIES

12-4-72—Filed Memorandum in opposition to plaintiff's motion for class action determination.

12-7-72—Filed Notice of Motion ret. 12-29-72 at 10 AM re: dismiss. summary judgment.

12-7-72—Filed Affidavit in support of defendants' motion to dismiss and for summary judgment. (by attorneys for New York Stock Exchange).

12-7-72—Filed Memorandum in support of motion for summary judgment.

12-7-72—Filed Affidavit in support of defendants' motion (Robert M. Bishop) to dismiss and for summary judgment. (for N.Y. Stock Exchange, Inc. and Bache & Co. Inc.) with one red portfolio of Exhibits.

12-7-72—Filed Affidavit of John P. Foynes in support of defendants' motion for summary judgment.

1-2-73—Filed Memorandum in opposition to defendants' motion to dismiss and for summary judgment.

5-10-73—Filed Affidavit of Richard A. Gordon in opposition to motion to dismiss and for summary judgment.

6-8-73—Filed stip. and order that the plaintiff may serve reply papers with respect to his pending motion for a class action before 6-4-73, so Ordered Lasker, J.

Filed stip. and order that plaintiff's time to serve reply papers with respect to motion for a class action determination is extended to 7-5-73. So Ordered Lasker J.

12-4-73—Filed memorandum OPINION No. 40,086—Defendants' motion for summary judgment is granted. In view of our decision here, we do not consider plaintiff's motion for a class action determination. It is so ordered—

Lasker, J.—mailed notice.

12-6-73—Filed plaintiffs' notice of appeal, $5.00 from Order dated Dec. 4-73, granting summary judgment to the defendants. Mailed copies.

A TRUE COPY
RAYMOND F. BURGHARDT, Clerk

DOCKET ENTRIES

12/12/73—Filed copies of docket entries and notice of appeal.

1/10/74—Received docket fee.

1/10/74—Filed record (original papers of the District Court).

2/14/74—Filed order extending time to file appellants brief and appendix to 3-29-74 (on consent).

3/7/74—Filed supplemental record (original papers of District Court).

3/28/74—Filed appendix, p/s.

3/28/74Filed brief, appellant, p/s.

4/9/74—Filed brief, Amicus Curiae, p/s (by mail) (U.S.A.).

4/29/74—Filed brief, appellee, p/s.

4/29/74—Filed order extending time to file amicus curiae brief (S.E.C.) to 5-24-74 (on consent).

4/30/74—Filed certificate of service on change in brief, appellee.

5/10/74—Filed motion for leave to participate in oral argument, p/s (U.S.A.)

5/10/74—Filed reply brief, appellant, p/s.

5/14/74—Filed order granting motion for leave to participate in oral argument of the appeal. Amicus will have ten (10) minutes for argument (U.S.A.)

5/17/74—Filed motion for leave to participate in oral argument, p/s (S.E.C.)

5/21/74—Filed order granting leave to participate in argument (10) minutes, (S.E.C.).

5/28/74—Filed brief, p/s (S.E.C.) (by mail).

6/5/74—Argument heard by: (Kaufman, Mansfield, Mulligan).

6/28/74—Judgment affirmed, Kaufman, CCJ.

6/28/74—Filed judgment.

7/9/74—Filed itemized and verified bill of costs, appellees, p/s

7/10/74—Filed affirmation in opposition to proposed bill of costs w/pfs.

7/11/74—Filed affidavit in response to affidavit in opposition to bill of costs w/pfs.

9/18/74—Filed statement of costs.

9/18/74—Issued mandate (opinion and judgment and statement of costs).

9/30/74—Filed notice of filing petition for writ of certiorari (SC# 74-304).

11/26/74—Filed certified copy of order of Supreme Court granting petition for writ of certiorari (SC# 74-304).

12/17/74—Original and supplemental record returned to district court.

COMPLAINT

(SAME TITLE)

CLASS ACTION

PLAINTIFF ALLEGES:

FIRST: At all times hereinafter mentioned plaintiff was, and still is, a citizen and resident of the STATE OF NEW YORK, doing business at 19 West 24th Street, New York, N.Y.

SECOND: Plaintiff is a purchaser of stocks through member firms of the New York Stock Exchange and American Stock Exchange.

THIRD: Plaintiff is President of the INDEPENDENT INVESTORS PROTECTIVE LEAGUE, an unincorporated association, having its' office and place of business at 19 West 24th Street, New York, N.Y. The said INDEPENDENT INVESTORS PROTECTIVE LEAGUE is composed of members who also are purchasers of stocks through member firms of the New York Stock Exchange and American Stock Exchange.

FOURTH: Plaintiff, and the members of the INDEPENDENT INVESTORS PROTECTIVE LEAGUE are "small Investors" purchasing stocks in amounts less than Five Hundred Thousand ($500,000) Dollars for each purchase.

FIFTH: This action is a Class Suit in behalf of plaintiff, individually, in behalf of the members of the INDEPENDENT INVESTORS PROTECTIVE LEAGUE and in behalf of the remaining members of the Class of "small investors" who purchase stocks listed on the New York Stock Exchange and American Stock Exchange in amounts less than Five Hundred Thousand ($500,000) Dollars for each purchase. It is believed that the members of this class amount to at least One Million (1,000,000)

persons and the amount of commissions paid by these persons to member firms of the New York Stock Exchange or American Stock Exchange during the past six years amounted to at least Five Hundred Million ($500,000,000) Dollars.

SIXTH: The defendants NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., are, on information and belief, corporations duly organized and existing under the laws of the State of New York, having offices and places of business within the territorial jurisdiction of the Southern District of New York.

SEVENTH: The defendants NEW YORK STOCK EXCHANGE, INC. and AMERICAN STOCK EXCHANGE, INC. represent the principal markets for equity securities in the United States. These organizations are, in effect, "public utilities" purportedly providing honest auction market for the purchase and sale of stocks of American Business Corporations. The prices at which these securities are sold are purportedly arrived at by fair bargaining between buyers and sellers of these stocks.

EIGHTH: All trading performed on the NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE is done through the agency of "members" of the said exchanges. The number of these "members" is arbitrarily limited by the said NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE and any person, firm, corporation or association who desires trading privileges upon the said Exchanges must purchase a "seat" from an existing member at a price arrived at between the seller and purchaser.

NINTH: The said NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE are purportedly subject to regulation by the SECURITIES AND EXCHANGE COMMISSION. This regulation, however, does

not affect Commission Charges or operations of the said Exchanges.

TENTH: In a recent Court Decision it has been held that the said NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE are subject to the Anti-Trust Laws of the United States.

ELEVENTH: This Court acquires jurisdiction of this suit by reason of the Constitution and Laws of the United States, in particular the Securities Act and the Anti-Trust Laws. The specific Anti-Trust Laws applicable to this case are 15 USC 1 and 15 USC 2 (The Sherman Act) and 15 USC 13 (The Robinson Patman Act) and plaintiff is a "person injured" as provided in 15 USC 15.

TWELFTH: The defendants MERRILL, LYNCH, PIERCE, FENNER AND SMITH, INC. and BACHE AND COMPANY, INC. are "members" of the NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE. These defendants are being sued herein individually and as representatives of all "members" of the aforesaid Exchanges.

THIRTEENTH: About 1968 the defendants BACHE AND COMPANY, INC. and MERRILL, LYNCH, PIERCE, FENNER AND SMITH, INC. as well as all of the other "members" of the aforesaid Exchanges, instituted a "surcharge" for small investors purchasing less than One Thousand (1,000) shares of stock in any one trade. The aforesaid "members" by this device received, on information and belief, at least One Hundred Million ($100,000,000) Dollars in additional income by reason of these increased commission rates.

FOURTEENTH: In truth and in fact it is no more expensive to conduct a so-called "small trade" than a large trade. By the use of modern computer data-processing techniques a "small trade" can be performed quickly and expeditiously and with minimum cost. The real additional

expense to the "member firms" of the so-called "small trade" is the expense of the so-called "Registered Representatives" of these "member firms" (in reality "Commission Salesmen" who expend considerable time in soliciting these accounts.

FIFTEENTH: In truth and in fact it is more expensive to consummate a "large trade". Such trade requires extensive negotiations and time.

SIXTEENTH: As a result of the above the aforesaid "surcharge" imposed by "member firms" upon "small investors" and the increased commissions charged by said "member firms" to said "small investors" are illegal and in violation of 15 USC 13 (The Robinson Patman Act). In addition the discounts given for "large trades" are likewise illegal and in violation of 15 USC 13. In addition these discounts constitute "unreasonably low prices" in violation of 15 USC 13a.

SEVENTEENTH: The defendants NEW YORK STOCK EXCHANGE and AMERICAN STOCK EXCHANGE likewise forbid the use of their facilities to any "non-member". In addition their rules and regulations prevent a division of commissions between "members" and "non-members". As a result organizations such as the plaintiff INDEPENDENT INVESTORS PROTECTIVE LEAGUE cannot offer trading facilities to their members. By means of the computerized trading methods developed by the plaintiff and the fact that the plaintiff INDEPENDENT INVESTORS PROTECTIVE LEAGUE need not utilize "Registered Representatives" as Commission Salesmen, the said League would be in a position to offer its' members substantial commission savings on stock trades. However, because of the present attitude on the part of the defendants NEW YORK STOCK EXCHANGE, INC. and AMERICAN STOCK EXCHANGE, INC., it is not able to do so. Such conduct on the part of the said defendants constitutes a violation of 15 USC 1 and 15

USC 2 (The Sherman Act), since the said Acts constitute a combination and conspiracy in restraint of trade and an attempt to create a monopoly in stock trading.

EIGHTEENTH: The said defendants NEW YORK STOCK EXCHANGE, INC. and AMERICAN STOCK EXCHANGE, INC. together with the "members" thereof, of which the defendants MERRILL, LYNCH, PIERCE, FENNER & SMITH and BACHE AND COMPANY are representatives, intend, on April 5th, 1971, to further deteriorate the position of the "small investor" by permitting negotiated commission rates on all trades over Five Hundred Thousand ($500,000) Dollars while keeping the extra commission rates in effect for "small investors".

NINETEENTH: The aforesaid negotiated commission rates are illegal for the following reasons:

(a). The opportunity of negotiating commission rates, if granted to any customer, must be granted to call customers under the provisions of 15 USC 13. Therefore, if negotiated commission rates are to be allowed for large trades they must also be allowed for small trades.

(b). The negotiated commission rates would not reflect "due allowance" for any cost savings.

(c). The negotiated commission rates would, in effect, restrict trading to large traders such as institutions, mutual funds, and the like. This would have the effect of "freezing out" the small investor from the market and would force the investor to invest through mutual funds and the like. This would, in effect, give mutual funds (in reality profit-making organizations) preferred access to the securities markets in the United States in violation of the Anti-Trust Laws.

(d). The negotiated commission rates would further cause the securities markets to become "stores" offering fixed negotiated prices for the sale of securities rather than the present "auction market". The possibilities of

manipulation and fraud that could be had in such case are endless.

NINETEENTH: *SPECIAL JURISDICTIONAL ALLEGATIONS REQUIRED FOR CLASS ACTION LITIGATION*

(a)

1. This Court acquires jurisdiction of this Cause of Action by virtue of the Securities Act of the United States and the Anti-Trust Laws of the United States.

2. The number of members of the classes involved in this action is as follows:

a. There are about One Hundred (100) member firms of the New York Stock Exchange and about One Hundred member firms of the American Stock Exchange.

b. There are about Fifty Million (50,000,000) small investors in the United States affected by this litigation.

3. There are common questions of law and fact involved in this litigation relating to the legality of the "surcharges imposed by the defendants NEW YORK STOCK EXCHANGE AND AMERICAN STOCK EXCHANGE and the legality of the "negotiated commission" rates for large trades to be instituted by the defendant Exchanges. There are also questions of law and fact in common with respect to the legality of the defendant Exchanges permitting trading utilizing their facilities only through "members". These questions predominate and are decisive over any questions involving only individual members of the Classes involved.

4. The plaintiff INDEPENDENT INVESTORS PROTECTIVE LEAGUE is the proper party to represent the Class on behalf of the "small investors" since it is the only organization specifically designed to protect small investors. The organization has, at present, less than One

Hundred (100) members but it is expected that it will have over One Million (1,000,000) members before this litigation is terminated. All present members of the INDEPENDENT INVESTORS PROTECTIVE LEAGUE have authorized this litigation and agree to have their names listed as parties thereto if necessary.

5. It is adequate to serve only the defendants MERRILL LYNCH PIERCE FENNER & SMITH and BACHE & COMPANY because these defendants are the two leading member firms of the defendant Exchanges who intend to impose negotiated commission rates and who have charged small investors surcharges. These parties are adequate to represent the Class of said member firms.

6. It is impracticable to join all members of the Classes involved herein since there are Fifty Million (50,000,000) small investors in the United States and it further would be impractical to join One Hundred (100) member firms of the defendant exchanges.

7. The claims and/or defenses of the representative parties involved herein are typical of the claims and defenses of the class.

8. A class action is the only proper way to determine the present controversy.

9. The plaintiffs have met the requirements of Rules 23 (a) and 23 (b) and Rule 23.2 of the Federal Rules of Civil Procedure.

9. The plaintiffs agree to permit any member of the Classes involved herein to intervene in this action or will permit any member of the class of "small investors" to join in this action and contribute to the expenses thereof.

10. It is expected that the Court will make appropriate orders in this case to protect the interests of the Classes involved.

TWENTIETH: By reason of the illegal practices set forth in this Complaint that plaintiff and others similarly

situated, have been seriously damaged for the following reasons as well as others, and, if the illegal practices are not terminated, will suffer further and irreparable damage in the future:

a. The plaintiffs have overpaid commissions in their purchases by reason of the imposition by the "member firms" of an illegal surcharge.

b. The plaintiffs will no longer have equal access to the securities markets in the same terms and conditions as mutual funds institutional investors.

c. The plaintiffs will be required to pay commissions to mutual fund managers and the like to have equal access to the securities markets and will lose discretionary control over their securities investments.

d. The plaintiffs will be deprived of a true auction market with respect to the purchase and sale of securities.

e. The plaintiffs will not have access to the securities markets on the same basis as "member firms" and will not be able to offer their members low cost securities purchase and sale service.

TWENTY-FIRST: With respect of many of the practices set forth herein plaintiff has no adequate remedy at law. With respect to the damage claims set forth therein plaintiff demands a Trial by Jury of all Issues triable before a jury.

TWENTY-SECOND: WHEREFORE, PLAINTIFFS DEMAND:

a. A perpetual injunction restraining the defendants, and all "members" of the defendant Exchanges, from putting the so-called "negotiated Commission Rates" in effect on April 5th, 1971.

b. A preliminary injunction restraining the defendants and all members of the defendant Exchanges, pending the trial of this action, from putting the so-called "negotiated commission rates" into effect on April 5th, 1971.

c. A mandatory injunction requiring the defendants NEW YORK STOCK EXCHANGE, INC. and AMERICAN STOCK EXCHANGE, INC. to permit the plaintiff INDEPENDENT INVESTORS PROTECTIVE LEAGUE, to conduct trading activities on the defendant Exchanges without having to purchase "seats" thereupon.

d. Damages in the sum of Five Hundred Million Dollars ($500,000,000) trebled to One Billion Five Hundred Million Dollars ($1,500,000,000) together with an attorney's fee of Ten Million Dollars ($10,000,000) together with interest and the costs and disbursements of this action.

e. As alternative relief, if the Court should decide that the defendants are entitled to permit negotiated commission rates that such negotiated rates be open to all investors and not merely to large investors.

f. A perpetual injunction restraining the defendants, and all "member firms" from continuing their discrimination in commission rates between large investors and small investors.

Yours, etc.

BADER AND BADER
By:
I. Walton Bader
Attorneys for Plaintiff
274 Madison Avenue
New York, N.Y. 10016
Tel. (212) LE2-6860

ANSWER

(SAME TITLE)

Defendants NEW YORK STOCK EXCHANGE, INC. (the "Exchange") and BACHE & COMPANY, INC. ("Bache") by their attorneys, Milbank, Tweed, Hadley & McCloy, for their answer to the complaint:

1. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs FIRST through FOURTH.

2. Deny each and every allegation contained in paragraph FIFTH except deny knowledge or information sufficient to form a belief as to those allegations stated to be based upon plaintiff's belief.

3. Admit the allegations contained in paragraph SEVENTH except deny that the Exchange and the AMERICAN STOCK EXCHANGE (the "Amex") are, in effect, "public utilities".

4. Deny each and every allegation contained in paragraph EIGHTH except admit that all trading of securities listed on the Exchange or the Amex is performed by respective members of those exchanges, that the number of said members is limited by the number of available memberships and that membership is acquired by purchase in a competitive auction market.

5. Deny each and every allegation contained in paragraph NINTH and admit that the Exchange and the Amex are subject to regulation by the Securities and Exchange Commission (the "SEC").

6. Declare that they are not required to plead to the allegations of law pleaded in paragraph TENTH.

7. Deny each and every allegation contained in paragraph ELEVENTH.

8. Deny each and every allegation contained in paragraph TWELFTH except admit that defendants MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. ("Merrill, Lynch") and Bache are member organizations of the Exchange and the Amex and are purportedly sued individually and as representatives of an alleged class of "members" of the defendant exchanges.

9. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs THIRTEENTH except admit that in or about December, 1968 the defendant exchanges, with the approval of the SEC, adopted rules providing for a volume discount for transactions involving more than one thousand (1,000) shares and that in or about April, 1970, the defendant exchanges, again with the approval of the SEC, adopted rules providing for an interim service charge to be imposed upon transactions of one thousand (1,000) shares of stock or less and that in or about March, 1972, the interim service charge was discontinued and a new commission rate schedule adopted, with the approval of the SEC and the Price Commission, incorporating a value-related volume discount.

10. Deny each and every allegation contained in paragraphs FOURTEENTH through SIXTEENTH.

11. Deny each and every allegation contained in paragraph SEVENTEENTH except admit that only members of the defendant exchanges may use the facilities of their respective exchanges.

12. Deny each and every allegation contained in paragraph EIGHTEENTH except admit that in or about April, 1971, the defendant exchanges, pursuant to a directive issued by the SEC after a series of public hearings, adopted rules permitting the negotiation of commission rates on that portion of transactions in securities listed on the defendant exchanges in excess of Five Hundred Thousand Dollars ($500,000) and that in April, 1972 said

rules were amended, pursuant to a request of the SEC, to permit negotiation of commission rates on that portion of transactions in listed securities in excess of Three Hundred Thousand Dollars ($300,000).

13. Deny each and every allegation contained in paragraph NINETEENTH.

14. Deny each and every allegation contained in paragraph NINETEENTH (a) except deny knowledge or information sufficient to form a belief as to the allegations respecting the membership of the Independent Investors Protective League or the authorization to institute suit purportedly granted by the members of said organization contained in paragraph 19(a)(4) and declare that defendants need not plead in response to the allegations contained in paragraph 19(a)(9) through 19(a)(10).

15. Deny each and every allegation contained in paragraphs TWENTIETH and TWENTY-FIRST.

FIRST DEFENSE

16. The complaint fails to state the claim upon which relief can be granted and this Court lacks subject matter jurisdiction over the controversy alleged.

SECOND DEFENSE

17. Pursuant to its self-regulatory duties under the Securities Exchange Act of 1934 (15 U.S.C. §78a *et seq.*) the Exchange has adopted rules limiting membership and fixing minimum rates of commission and other charges, including the specific volume discount effective from December, 1968 to March, 1972, the interim service charge ("surcharge") effective from April, 1970 to March, 1972 and rules relating to negotiated commissions with respect to transactions in securities listed on the Exchange. All of the said rules are subject to review and revision by the SEC

under Section 19(b) of the Exchange Act and such review jurisdiction is continuing to be exercised. By reason thereof neither the adoption of, nor the adherence to, said rules may be the subject of an antitrust claim because exclusive jurisdiction of the subject matter is vested in the SEC.

THIRD DEFENSE

18. The imposing of limitations on membership and the fixing of minimum rates of commission and charges, including the specific volume discount effective December, 1968 to March, 1972, and the surcharge effective from April, 1970 to March, 1972 and rules relating to negotiated commissions, by the Exchange are within the scope and carry out the purposes of the Securities Exchange Act of 1934 (15 U.S.C. §§78a et seq.) and are therefore exempt from the operation of the antitrust laws.

FOURTH DEFENSE

19. The fixing of minimum rates of commission and charges, imposing limitations on membership and establishing the specific volume discount effective December, 1968 to March, 1972, and the rules relating to negotiated commissions by the Exchange were, and are, reasonable and justified and therefore not in contravention of the antitrust laws.

FIFTH DEFENSE

20. Since the Securities Exchange Act of 1934 (U.S.C. §§78a *et seq.*) provides for review and revision by the SEC of the Exchange's rules relating to membership, minimum rates of commission and other charges, primary jurisdiction of the subject matter of this action is vested in the SEC.

SIXTH DEFENSE

21. Plaintiff lacks standing to assert a claim under the antitrust laws either as President of the Independent Investors Protective League or on behalf of its members or on behalf of an alleged class of small investors and further lacks standing to sue individually because he has not been directly injured in his business or property by reason of anything forbidden in the antitrust laws.

SEVENTH DEFENSE

22. Any claim for damages which accrued more than four years prior to the commencement of this action is barred by the applicable statute of limitations (15 U.S.C. §15b).

EIGHTH DEFENSE

23. By reason of the plaintiff's tardy assertion of the illegality of the Exchange rules and regulations with respect to the volume discount effective from December, 1968 to March, 1972 and the interim service charge instituted in April, 1970 and discontinued in March, 1972 and the payment to the defendant member organizations of commissions and other charges, including the surcharge in accordance with the schedules established by the Exchange and defendants' reliance upon the apparent acquiescence of the plaintiff and the purported class, plaintiff and the alleged class are guilty of laches and are estopped from asserting any claim against these defendants.

NINTH DEFENSE

24. All the rules challenged herein were promulgated and adopted by the Exchange and adhered to by the member organizations pursuant to an order, request or the

approval of the SEC and consequently the Exchange and the member organizations thereof should not be held liable for any violation of law occasioned therefor by reason of the good faith reliance by the defendants upon the authority and jurisdiction of the SEC.

WHEREFORE, defendants the Exchange and Bache, demand judgment dismissing the complaint with costs and disbursements.

Dated: New York, New York
September 18, 1972

MILBANK, TWEED, HADLEY &McCLOY
By s/
(a member of the firm)
1 Chase Manhattan Plaza
New York, N.Y. 10005
Attorneys for defendants
New York Stock Exchange, Inc. and Bache & Company, Inc.

ANSWER OF DEFENDANT MERRILL, LUNCH, PIERCE, FENNER & SMITH INC.

(SAME TITLE)

Defendant Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") by its attorneys, Brown, Wood, Fuller, Caldwell & Ivey, for its answer to the complaint:

1. Denies knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs FIRST through FOURTH.

2. Denies each and every allegation contained in paragraph FIFTH except denies knowledge or information sufficient to form a belief as to those allegations stated to be based upon plaintiff's belief.

3. Admits the allegations in paragraph SIXTH of the complaint, except avers that Merrill Lynch is incorporated under the laws of the State of Delaware.

4. Admits the allegations contained in paragraph SEVENTH except denies that the New York Stock Exchange, Inc. (the "Exchange") and the American Stock Exchange (the "Amex") are, in effect, "public utilities".

5. Denies each and every allegation contained in paragraph EIGHTH except admits that all trading of securities listed on the Exchange or the Amex is performed by respective members of those exchanges, that the number of said members is limited by the number of available memberships and that membership is acquired by purchase in a competitive auction market.

6. Denies each and every allegation contained in paragraph NINTH except admits that the Exchange and the Amex are subject to regulation by the Securities and Exchange Commission (the "SEC").

7. Declares that it is not required to plead to the

allegations of law pleaded in paragraph TENTH.

8. Denies each and every allegation contained in paragraph ELEVENTH.

9. Denies each and every allegation contained in paragraph TWELFTH except admits that Merrill Lynch is a member organization of the Exchange and the Amex and is purportedly sued individually and as representative of an alleged class of "members" of the defendant exchanges.

10. Denies knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph THIRTEENTH except admits that in or about December, 1968 the defendant exchanges, with the approval of the SEC, adopted rules providing for a volume discount for transactions involving more than one thousand (1,000) shares and that in or about April, 1970, the defendant exchanges, again with the approval of the SEC, adopted rules providing for an interim service charge to be imposed upon transactions of one thousand (1,000) shares of stock or less and that in or about March, 1972, the interim service charge was discontinued and a new commission rate schedule adopted, with the approval of the SEC and the Price Commission, incorporating a value-related volume discount.

11. Denies each and every allegation contained in paragraphs FOURTEENTH through SIXTEENTH.

12. Denies each and every allegation contained in paragraph SEVENTEENTH except admits that only members of the defendant exchanges may use the facilities of their respective exchanges.

13. Denies each and every allegation contained in paragraph EIGHTEENTH except admits that in or about April, 1971, the defendant exchanges, pursuant to a directive issued by the SEC after a series of public hearings, adopted rules permitting the negotiation of commission rates on that portion of transactions in securities listed on

the defendant exchanges in excess of Five Hundred Thousand Dollars ($500,000) and that in April, 1972 said rules were amended, pursuant to a request of the SEC, to permit negotiation of commission rates on that portion of transactions in listed securities in excess of Three Hundred Thousand Dollars ($300,000).

14. Denies each and every allegation contained in paragraph NINETEENTH.

15. Denies each and every allegation contained in paragraph NINETEENTH (a) except denies knowledge or information sufficient to form a belief as to the allegations respecting the membership of the Independent Investors Protective League or the authorization to institute suit purportedly granted by the members of said organization contained in paragraph 19(a)(4) and declares that defendants need not plead in response to the allegations contained in paragraph 19(a)(9) through 19(a)(10).

16. Denies each and every allegation contained in paragraphs TWENTIETH and TWENTY-FIRST.

FIRST DEFENSE

17. The complaint fails to state a claim upon which relief can be granted and this Court lacks subject matter jurisdiction over the controversy alleged.

SECOND DEFENSE

18. Pursuant to its self-regulatory duties under the Securities Exchange Act of 1934 (15 U.S.C. §78a *et seq.*) the Exchange has adopted rules limiting membership and fixing minimum rates of commission and other charges, including the specific volume discount effective from December, 1968 to March, 1972, the interim service charge ("surcharge") effective from April, 1970 to March, 1972 and rules relating to negotiated commissions with respect

to transactions in securities listed on the Exchange. All of the said rules are subject to review and revision by the SEC under Section 19(b) of the Exchange Act and such review jurisdiction is continuing to be exercised. By reason thereof neither the adoption of, nor the adherence to, said rules may be the subject of an antitrust claim because exclusive jurisdiction of the subject matter is vested in the SEC.

THIRD DEFENSE

19. The imposing of limitations on membership and the fixing of minimum rates of commission and charges, including the specific volume discount effective December, 1968 to March, 1972, and the surcharge effective from April, 1970 to March, 1972 and rules relating to negotiated commissions, by the Exchange are within the scope and carry out the purposes of the Securities Exchange Act of 1934 (15 U.S.C. §78a *et seq.*) and are therefore exempt from the operation of the antitrust laws.

FOURTH DEFENSE

20. The fixing of minimum rates of commission and charges, imposing limitations on membership and establishing the specific volume discount effective December, 1968 to March, 1972, and the rules relating to negotiated commissions by the Exchange were, and are, reasonable and justified and therefore not in contravention of the antitrust laws.

FIFTH DEFENSE

21. Since the Securities Exchange Act of 1934 (U.S.C. §78 *et seq.*) provides for review and revision by the SEC of the Exchange's rules relating to membership, minimum rates of commission and other charges, primary jurisdiction of the subject matter of this action is vested in the SEC.

SIXTH DEFENSE

22. Plaintiff lacks standing to assert a claim under the antitrust laws either as President of the Independent Investors Protective League or on behalf of its members or on behalf of an alleged class of small investors and further lacks standing to sue individually because he has not been directly injured in his business or property by reason of anything forbidden in the antitrust laws.

SEVENTH DEFENSE

23. Any claim for damages which accrued more than four years prior to the commencement of this action is barred by the applicable statute of limitations (15 U.S.C. §15b).

EIGHTH DEFENSE

24. By reason of the plaintiff's tardy assertion of the illegality of the Exchange rules and regulations with respect to the volume discount effective from December, 1968 to March, 1972 and the interim service charge instituted in April, 1970 and discontinued in March, 1972 and the payment to the defendant member organizations of commissions and other charges, including the surcharge in accordance with the schedules established by the Exchange and defendant's reliance upon the apparent acquiescence of the plaintiff and the purported class, plaintiff and the alleged class are guilty of laches and are estopped from asserting any claim against this defendant.

NINTH DEFENSE

25. All the rules challenged herein were promulgated and adopted by the Exchange and adhered to by the member organizations pursuant to an order, request or the

approval of the SEC and consequently the Exchange and the member organizations thereof should not be held liable for any violation of law occasioned therefor by reason of the good faith reliance by the defendants upon the authority and jurisdiction of the SEC.

WHEREFORE, defendant Merrill Lynch demands judgment dismissing the complaint with costs and disbursements.

Dated: New York, New York
September 28, 1972

BROWN, WOOD, FULLER, CALDWELL & IVEY
By s/Roger J. Hawke
(A member of the Firm)
Attorneys for Defendant
Merrill Lynch, Pierce, Fenner
and Smith Incorporated
One Liberty Plaza
New York, New York 10006
(212) 349-7500

ANSWER OF DEFENDANT AMERICAN STOCK EXCHANGE, INC.

(SAME TITLE)

Defendant American Stock Exchange, Inc. by its attorneys, Davis Polk & Wardwell, answering the complaint herein upon information and belief:

1. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph FIRST.

2. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph SECOND.

3. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph THIRD.

4. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph FOURTH.

5. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph FIFTH, except admits that plaintiff purports to bring this action on behalf of those persons described in paragraph FIFTH, but denies that this action is validly brought as a class action under Rule 23 of the Federal Rules of Civil Procedure and further denies that the persons so described constitute a class within the meaning of said Rule.

6. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph SIXTH, except admits that the American Stock Exchange, Inc. is a corporation duly organized and existing under the laws of the State of New York, and has an office and place of business at 86 Trinity Place, City and

State of New York and admits that the American Stock Exchange, Inc. is registered with the Securities and Exchange Commission as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §78f and that the American Stock Exchange, Inc. has filed with the Securities and Exchange Commission, in accordance with said Section 6, copies of its Constitution and rules and all amendments thereto.

7. Denies each and every allegation set forth in paragraph SEVENTH, except admits that the New York Stock Exchange, Inc. and the American Stock Exchange, Inc. maintain honest auction markets for the purchase and sale of securities at prices arrived at by fair bargaining between buyers and sellers of these securities.

8. Denies each and every allegation set forth in paragraph EIGHTH, except admits that the New York Stock Exchange, Inc. and the American Stock Exchange, Inc. maintain markets where securities listed on those exchanges can be purchased and sold by members of those exchanges on behalf of themselves, their member organizations, and their customers, that the number of said members is limited by the number of available memberships and that membership is acquired by purchase in a competitive auction market.

9. Denies each and every allegation set forth in paragraph NINTH, except admits that the New York Stock Exchange, Inc. and the American Stock Exchange, Inc. are subject to regulation by the Securities and Exchange Commission.

10. Declares that it is not required to plead to the allegations of law pleaded in paragraph TENTH.

11. Denies each and every allegation set forth in paragraph ELEVENTH.

12. Denies each and every allegation set forth in

paragraph TWELFTH, except admits that defendants Merrill Lynch, Pierce, Fenner and Smith, Inc. and Bache and Company, Inc. are member organizations of the New York Stock Exchange, Inc. and the American Stock Exchange, Inc. and are purportedly being sued individually and as representatives of an alleged class of "members" of the defendant exchanges.

13. Denies knowledge or information sufficient to form a belief as to the truth of the allegations set forth in paragraph THIRTEENTH, except admits that in or about December, 1968 the defendant exchanges, with the approval of the Securities and Exchange Commission, adopted rules providing for a volume discount for transactions involving more than one thousand (1,)))) shares and that in or about April, 1970, the defendant exchanges, again with the approval of the Securities and Exchange Commission, adopted rules providing for an interim service charge to be imposed upon transactions of one thousand (1,000) shares of stock or less and that in or about March, 1972, a new commission rate schedule was adopted, and in or about April, 1972, the interim service charge was discontinued, with the approval of the Securities and Exchange Commission and the Price Commission, incorporating a value-related volume discount.

14. Denies each and every allegation set forth in paragraph FOURTEENTH.

15. Denies each and every allegation set forth in paragraph FIFTEENTH.

16. Denies each and every allegation set forth in paragraph SIXTEENTH.

17. Denies each and every allegation set forth in paragraph SEVENTEENTH, except admits that only members of the defendant exchanges may use the facilities of their respective exchanges, and refers to the published rules and regulations of the American Stock Exchange, Inc. for the terms thereof.

18. Denies each and every allegation set forth in paragraph EIGHTEENTH.

19. Denies each and every allegation set forth in paragraph NINETEENTH.

19(a). Denies each and every allegation set forth in paragraph NINETEENTH (a), except denies knowledge or information sufficient to form a belief as to the allegations set forth in paragraph NINETEENTH (a) 4 respecting the membership of the Independent Investors Protective League or the authorization to institute suit purportedly granted by the members of said organization, and declare that defendant the American Stock Exchange, Inc. need not plead in response to the allegations set forth in paragraph NINETEENTH (a)0 (second of two such paragraphs) through NINETEENTH (a)10.

20. Denies each and every allegation set forth in paragraph TWENTIETH.

21. Denies each and every allegation set forth in paragraph TWENTY-FIRST.

AS AND FOR A FIRST AFFIRMATIVE DEFENSE

22. The complaint fails to state facts sufficient to constitute a cause of action.

AS AND FOR A SECOND AFFIRMATIVE DEFENSE

23. Jurisdiction over the subject matter of this complaint is vested solely and exclusively with the Securities and Exchange Commission.

AS AND FOR A THIRD AFFIRMATIVE DEFENSE

24. By reasons of the provisions of the Securities and Exchange Act of 1934, as amended, 15 U.S.C. §78a *et seq.*, and the actions of the Securities and Exchange

Commission thereunder, the acts of the American Stock Exchange, Inc. alleged in the complaint are exempt and immune from the provisions of the Robinson-Patman Act and the Sherman Act upon which the complaint is predicated.

AS AND FOR A FOURTH AFFIRMATIVE DEFENSE

25. The subject matter of the complaint is within the primary jurisdiction of the Securities and Exchange Commission.

AS AND FOR A FIFTH AFFIRMATIVE DEFENSE

26. The fixing of minimum rates of commission and charges, imposing limitations on membership and establishing the specific volume discount effective December, 1968 to March, 1972, and the rules relating to negotiated commissions by the American Stock Exchange, Inc. were, and are, reasonable and justified and therefore not in contravention of the antitrust laws.

AS AND FOR A SIXTH AFFIRMATIVE DEFENSE

27. Plaintiff lacks standing to assert a claim under the antitrust laws either as President of the Independent Investors Protective League or on behalf of its members or on behalf of an alleged class of small investors because he has not been directly injured in his business or property by reason of anything forbidden in the antitrust laws.

AS AND FOR A SEVENTH AFFIRMATIVE DEFENSE

28. Plaintiff and the alleged class are guilty of laches and are estopped from asserting the claims they make in the complaint against the American Stock Exchange, Inc.

AS AND FOR AN EIGHTH AFFIRMATIVE DEFENSE

29. All the rules challenged herein were promulgated and adopted by the American Stock Exchange, Inc. and adhered to by the member organizations pursuant to an order, request or the approval of the Securities and Exchange Commission and consequently the American Stock Exchange, Inc. should not be held liable for any violation of law occasioned therefor by reason of the good faith reliance by the defendant upon the authority and jurisdiction of the Securities and Exchange Commission.

AS AND FOR A NINTH AFFIRMATIVE DEFENSE

30. Any claim against the American Stock Exchange, Inc. based on acts occurring more than four years prior to the commencement of this action is barred by the provisions of Section 4B of the Clayton Act, 14 U.S.C. § 15b.

WHEREFORE, defendant American Stock Exchange, Inc. demands judgment dismissing the complaint together with the costs and disbursements of this action.

Dated: New York, New York
September 29, 1972

DAVIS POLK & WARDWELL
By s/
Attorneys for the Defendant
American Stock Exchange, Inc.
1 Chase Manhattan Plaza
New York, N.Y. 10005
Tel. 212 HA 2-3400

DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

(SAME TITLE)

SIR:

PLEASE TAKE NOTICE that upon the pleadings herein, the affidavits of Robert M. Bishop, H. Vernon Lee, Jr., and John P. Foynes, and the annexed statement pursuant to Rule 9(g) of the General Rules of this Court, the undersigned will move this Court before the Hon. Morris E. Lasker at Room No. 2903, United States Court House, Foley Square, New York, N.Y., on December 29, 1972, at 10:00 a.m., or as soon thereafter as counsel can be heard, or at such other time and place as the Court shall direct, for an order pursuant to Rules 12(b) and 56 of the Federal Rules of Civil Procedure, dismissing the complaint and granting summary judgment in favor of defendants and against plaintiff, and for such other and further relief as is just and proper.

Dated: New York, N.Y.
December 4, 1972

Yours, etc.,

MILBANK, TWEED, HADLEY & McCLOY
By s/Isaac Shapiro
(A Member of the Firm)
Attorneys for defendants
New York Stock Exchange, Inc.
and Bache & Co., Inc.
1 Chase Manhattan Plaza
New York, N.Y. 10005

LORD, DAY & LORD
By s/John Loflin
(A Member of the Firm)
Attorneys for defendant
American Stock Exchange
25 Broadway
New York, N.Y. 10004

BROWN, WOOD, FULLER, CALDWELL & IVEY
By s/Roger J. Hawk
(A Member of the Firm)
Attorneys for defendant
Merrill Lynch, Pierce, Fenner
& Smith, Inc.
1 Liberty Plaza
New York, N.Y. 10006

TO: BADER AND BADER
Attorneys for plaintiff
274 Madison Avenue
New York, N.Y. 10006

DEFENDANTS' RULE 9(g)
STATEMENT IN SUPPORT OF MOTION
FOR SUMMARY JUDGMENT

(SAME TITLE)

Defendants respectfully submit that the following material facts are not in dispute.

1. The New York Stock Exchange (the "NYSE") and the American Stock Exchange (the "Amex") are corporations organized under the laws of the State of New York for the purpose of providing for their members and the public two-way auction markets in exchange listed stocks, bonds and other securities.

2. The NYSE presently has 1,366 members, all of whom are individuals. The Amex presently has 650 regular members and 217 associate members, all of whom are individuals. The NYSE has 527 member organizations and the Amex has over 500 member organizations.

3. Since their founding, the NYSE and the Amex at all times have had rules limiting their membership and prescribing the minimum commissions to be charged by members and member organizations on transactions executed for the investing public in securities dealt in on the respective exchanges.

4. The NYSE and the Amex were registered by the Securities and Exchange Commission (the "SEC") as national securities exchanges in 1934 pursuant to the provisions of Section 6 of the Securities Exchange Act of 1934 (the "1934 Act"). At the time of said registration, the respective constitutions and rules of the NYSE and the Amex were submitted to and approved by the SEC pursuant to the requirements of the 1934 Act.

5. Since registering with the SEC in 1934, the NYSE and the Amex have changed their respective constitutional

provisions and rules prescribing minimum commission rates a number of times. Copies of each such rule change or amendment were submitted by the exchanges to the SEC as required pursuant to Section 6(a)(4) of the 1934 Act and SEC Rule 17(a)-8.

6. The SEC, in carrying out its duty of supervision under Section 19(b) of the 1934 Act, studied and reviewed all the proposed changes. After such study and review the SEC in some instances permitted the proposed changes to become effective without modification; in other instances the SEC requested modifications in the proposed changes which were then adopted by the NYSE and the Amex.

7. In 1959, at the request of the SEC, the NYSE undertook a study which revealed that the inflexibility of the then prevailing commission rate structure had a potential for causing market dislocations because of the growth of institutional-size business. Beginning in 1965, the Amex undertook studies of its own intra-member and non-member commission rate structures, with particular emphasis on institutional-size transactions.

8. The period of study expended on the problem of a volume discount extended over a period of some six years—from 1962 to 1968. Both the NYSE and the SEC developed proposals to deal with market problems created by the absence of a volume discount. These proposals were made public and comment invited on January 26, 1968 in the SEC's Exchange Act Release No. 8239. On May, 1968, the SEC wrote the NYSE and the Amex advising of the Commission's determination that "changes in the present commission rate structure are required to benefit the investing public," and directing that interim adjustments be made in the exchange's commission rate structures pending a final revision at the conclusion of the SEC Rate Hearings. On December 5, 1968, the rules of the NYSE and the Amex were modified to provide for a volume discount on all public orders for securities listed on the

respective exchanges involving more than 100 shares of stock.

9. Studies prepared by the NYSE, the Amex, and the SEC indicated that the securities commission business was sorely pressed in late 1969 and early 1970 by reason of the peak volume demands, increasing costs (there had not been a commission increase in over a decade) and the diminution of revenues from institutional trades which were subject to a discount. In order to correct these difficulties and protect small investors—whose trades many brokerages would no longer accept—the NYSE and the Amex proposed to the SEC the imposition of an interim service charge on smaller orders. The SEC approved this proposal on the condition that the imposition of the service charge be for a strictly limited time and that the exchanges ensure that small investors were not discriminated against and that member organizations took all steps to ameliorate their financial problems. This interim service charge became effective on both exchanges in April, 1970. It was due to expire 90 days later, but because of continuing financial difficulties, the NYSE and the Amex proposed its extension. The SEC, after public hearings in July, 1970 approved. The interim service charge remained in effect from April, 1970 until April, 1972, when the present rate structures were enacted by the exchanges.

10. As a result of the intensive investigation of the commission rate structure over nearly a decade, including two SEC reports (The Special Study of 1963 and the Institutional Investor Study of 1971) and two years of testimony and evidence in the Rate Hearings, the SEC determined, in lage 1970, that fixed charges for portions of orders above a certain amount were neither necessary nor appropriate under the 1934 Act. The NYSE and the Amex each adopted the new rate proposal then urged by the SEC for the negotiation of commission rates on that portion of orders in excess of $500,000 (*i.e.*, $500,000 was established

as the "breakpoint" between fixed minimum and negotiated commission rates).

11. The $500,000 breakpoint was considered experimental and both exchanges instituted a program of monitoring the impact of negotiated rates, again at SEC direction. On February 2, 1972, the Commission announced its determination that the breakpoint should be lowered to $300,000. Both the NYSE and the Amex acceded and adopted the necessary changes in their respective constitutions in April, 1972.

12. During the course of the regulatory activity relating to the volume discount, interim service charge and negotiated commission rates, the SEC's Rate Hearings, commencing on July 1, 1968, received evidence and testimony on every aspect of the exchanges' commission rate structure. After the Hearings terminated in 1971, the NYSE proposed, and the SEC approved, the present rate schedule which was adopted by both exchanges in April, 1972. The present commission rate structure repealed the previously adopted volume discount and interim service charge and replaced it with a schedule of commission rates incorporating a cost-related discount for volume transactions as well as negotiated rates of commission on that portion of orders in excess of $300,000.

Dated: New York, New York
December 4, 1972

Respectfully submitted,

MILBANK, TWEED, HADLEY & McCLOY
1 Chase Manhattan Plaza
New York, N.Y. 10005
Attorneys for defendants
New York Stock Exchange, Inc.
and Bache & Co., Inc.

LORD, DAY & LORD
25 Broadway
New York, N.Y. 10004
Attorneys for defendant
American Stock Exchange, Inc.

BROWN, WOOD, FULLER,
CALDWELL & IVEY
1 Liberty Plaza
New York, New York
Attorneys for defendant
Merrill Lynch, Pierce, Fenner
& Smith, Incorporated

AFFIDAVIT OF H. VERNON LEE IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND EXHIBITS ANNEXED

(SAME TITLE)

STATE OF NEW YORK (
ss.:
COUNTY OF NEW YORK)

H. VERNON LEE, JR., being duly sworn, deposes and says:

1. I am Vice-President and Secretary of the American Stock Exchange (the "Amex"), a defendant herein, and I am familiar with this matter. I make this affidavit in support of the defendants' motion for an order dismissing the complaint filed in this action and granting summary judgment to the defendants.

2. The Amex is a New York corporation, incorporated under the New York Not-for-Profit Corporation Law, whose business and purpose is to provide a securities marketplace in New York City for its members who are brokers and dealers in securities. As a two-way auction market for securities listed on the Amex, activity in the Amex is characterized by competition both between and among buyers and sellers. The Amex presently has 650 regular members, who have direct access to the trading floor, and 217 associate members, who may do business on the trading floor only through a regular member. In addition, there are over 500 regular and associate member organizations, partnerships and corporations in which the general partners or the directors and major stockholders are Amex members or are approved by the Amex's Board of Governors.

3. The Amex was first organized in 1908 as the New York Curb Agency, an outdoor marketplace for corporate

securities. In 1921 the name was changed to the New York Curb Market and a constitution was adopted to coincide with the outdoor exchange's move indoors to its present location on Trinity Place. In 1953 the name was officially changed to the American Stock Exchange. Since its early days as an outdoor exchange, the Amex has maintained rules limiting access to its facilities and prescribing the minimum commission rates which could be charged to non-members on transactions in securities listed on the Amex. Members and member organizations who violate Amex rules with respect to the minimum commission rates chargeable to non-members are subject to disciplinary action.

4. Subsequent to the enactment of the Securities Exchange Act of 1934 (the "1934 Act"), the Amex submitted to the Securities and Exchange Commission (the "SEC") an application for registration as a national securities exchange. The Amex also submitted for SEC approval copies of its Constitution and Rules, which contained provisions requiring members to charge specified minimum commissions to non-members. The Amex was registered with the SEC on September 23, 1934. At the time of its registration the Amex was required by §6(a)(1) of the 1934 Act to agree "to comply, and to enforce . . . compliance by its members, with the provisions of [the 1934 Act] . . . and any rule or regulation . . . thereunder." The registration was granted upon findings by the SEC, as required by §§6(d) and 6(b) of the 1934 Act, that the Amex was "so organized as to be able to comply with the provisions of [the 1934 Act] . . . and the rules and regulations thereunder and the rules of the exchange are just and adequate to ensure fair dealing and to protect investors [,]" and further, that the rules of the Amex "include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade . . . "

5. Since the SEC originally approved the Constitution and Rules of the Amex upon its registration on September 23, 1934, the constitutional provisions and rules prescribing minimum commission rates chargeable to non-members have been changed by the Amex a number of times. The Amex has submitted copies of each rule change or amendment to the SEC as required pursuant to §6(a)(4) of the 1934 Act and SEC Rule 17(a)—8. The Amex's present constitutional provisions and rules relating to commission rates (annexed as Exhibits A and B) are the product of studies conducted by the Amex and the New York Stock Exchange (the "NYSE"), as well as hearings and studies conducted by the SEC [*Report of the Special Study of Securities Markets,* House Doc. No. 815, 88th Cong., 1st Sess. (1963) and *The Institutional Investor Study,* House Doc. No. 92-64, 92nd Cong., 1st Sess. (1970)].

6. In late 1962 the Costs and Revenues Committee of the NYSE, at the direction of the SEC, initiated a study of the need and feasability of implementing a volume discount for lage transactions in securities. In a report transmitted by the NYSE to the SEC on November 29, 1965, the Cost and Revenue Committee recognized the need for volume discounts due to the growing number of institutional-sized transactions and the lack of any provision in the existing non-member commission rate structure for discounts on block trades. In a later report submitted by the NYSE to the SEC on January 2, 1968, the Committee made specific proposals to minimize and control customer-directed "give-ups", the reciprocal and rebative methods block traders utilized to avoid commission rates. On January 26, 1968, the SEC proposed for adoption by national securities exchange Rule 10b-10, a provision which would restrict give-ups.

7. In 1965 the Amex commissioned Haskins and Sells, a major accounting firm, to undertake a study of the ex-

change's intra-member commission structure and to evaluate its fairness and adequacy. In early 1968, Amex's Board of Governors appointed a Subcommittee on Commission Structure [the "Subcommittee"], to review all aspects of the exchange's commission rates in light of changing market conditions, costs of doing business, and needs of the investing public. The Subcommittee submitted its first memorandum to Amex members and member organizations on April 19, 1968 (annexed as Exhibit C), in which it reported preliminary findings on the existing intra-member commission rates and solicited the opinions and suggestions of the Amex membership.

8. Amex President Ralph S. Saul transmitted the Subcommittee's April 19 memorandum to the SEC in a letter to Chairman Manuel F. Cohen on April 24, 1968. (Annexed as Exhibit D). In that letter, Mr. Saul informed Chairman Cohen that the Subcommittee was presently studying the commission rates charged to non-members of the Amex. Mr. Saul also expressed the Amex's opposition to the SEC's proposed Rule 10b-10 as not in the public interest, and advised that the Subcommittee would consider possible alternative methods for dealing with the problem of customer-directed give-ups.

9. On May 28, 1968, Chairman Cohen transmitted to the Amex a letter of the same date written to President Robert W. Haack of the NYSE advising that, as a result of its extensive and continuing study of the commission rate structure of national securities exchanges, the SEC believed "changes in the present commission rate structure are required to benefit the investing public." (The letter of transmittal to the Amex and the Haack letter are both annexed as Exhibit E). The letter contained a request by the SEC, pursuant to its authority under §19 (b) of the 1934 Act to fix reasonable rates of commission, that the NYSE, on or before September 15, 1968, make changes in its commission rates which would either (a) conform to an

SEC proposed commission schedule (attached to the Haack letter) or (b) eliminate minimum commission rates on all orders in excess of $50,000. This request was said to be made "in the context of the Commission's responsibilities to consider the national policies embodied both in the securities laws and in the antitrust laws." In his letter of transmittal to the Amex, Commissioner Cohen stated that "the Commission has not directed a similar letter to your Exchange because of possible differences in the situation prevailing" but "requests that you give immediate attention to appropriate modifications of your commission rate structure, including any necessary interim steps." The letter to President Haack also announced that the SEC, pursuant to its authority under §21(a) of the 1934 Act, would hold public hearings on the commission rate structure issue commencing July 1, 1968 (the "Rate Structure Hearings").

10. In a letter to the SEC on June 26, 1968, President Saul advised that after careful consideration of the Commission's proposed Rule 10b-10 and recent studies by the Amex staff, the Amex Board of Governors "has agreed in principle to eliminate . . . customer-directed give-ups . . . " (Annexed as Exhibit F). The letter also advised that the Board of Governors "has also agreed that a modification of the present minimum commission rate structure to provide volume discounts is also appropriate . . . " Finally, the letter stated that the Amex's staff had been directed by the Board of Governors "to work with the Commission to achieve meaningful and prompt implementation of the Board of Governors' position with respect to discounts and give-ups."

11. On September 20, 1968 the Subcommittee on Commission Structure transmitted to Amex members and member organizations a memorandum recommending adoption of a volume discount on transactions in securities involving more than 1,000 shares and an amendment to the

Amex's Constitution which would prohibit customer-directed give-ups. (Annexed as Exhibit G).

12. Pursuant to a vote of its membership, on December 5, 1968 the Amex effectuated amendments to its Constitution which provided for volume discounts on transactions in securities involving more than 1,000 shares, and prohibited customer-directed give-ups.

13. Between 1968 and 1970, because of a tremendous rise in the volume of public transactions on the national securities exchanges, the facilities and resources of Amex members became increasingly overburdened. The expense of expansion needed to meet the increased demand, as well as rising costs during a decade in which there had been no increase in commission rates, contributed to a drastic decline in the profits of the securities industry. The hardest hit were member organizations which primarily handled small orders for individual customers. The volume discount, which became effective on December 5, 1968, threatened only to exacerbate the situation because of the likelihood that it would reduce commission revenues.

14. On February 13, 1970 and March 16, 1970, the NYSE presented to the SEC statistical evidence demonstrating the financial distress of the securities industry and the need for interim relief in the form of an increase in commission rates. On March 19, 1970, the NYSE submitted to the SEC a proposed rule which would impose an interim service charge, in addition to the existing minimum commission rate, on all public transactions in listed securities involving 1,000 shares of stock or less.

15. In a letter to the SEC on March 26, 1970, the Amex expressed its support of the NYSE's proposed interim service charge and set forth the results of a survey conducted among Amex member organizations which indicated the need for temporary relief of that nature. (Annexed as Exhibit H).

16. In a letter to the NYSE on April 2, 1972, the SEC expressed its non-objection to the proposed interim service charge on transactions involving 1,000 shares or less. (Annexed as Exhibit I). The SEC stated that its own data had confirmed the loss experience of the industry and that "past losses and the prospect of continued financial drain have influenced many member firms to impose limitations on their services to small investors." The SEC conditioned its non-objection to the interim service charge upon its limitation to a 90 day period and the requirement that steps be taken to ensure the restoration of full brokerage services for small investors.

17. On April 2, 1972, the Amex transmitted to the SEC copies of its new Rule 396, which provided for an interim service charge essentially the same as that proposed by the NYSE. In its letter of transmittal, the Amex agreed to adhere to the conditions stated by the SEC in its letter of April 2 to the NYSE. (A copy of Rule 396 and the Amex's letter of transmittal to the SEC are annexed as Exhibit J). The interim service charge went into effect on April 6, 1970 and was to expire on July 6, 1970.

18. On April 10, 1970 the SEC responded to the Amex's April 2 submission with a letter expressing its non-objection to Rule 396 imposing an interim service charge. (Annexed as Exhibit K).

19. Prior to the expiration date of the interim service charge, studies conducted by the NYSE revealed that the financial condition of the securities industry had not improved. These findings were relayed to the SEC on June 18, 1970 by President Haack of the NYSE. In a letter on June 29, 1970, the Amex advised the SEC that economic conditions among its member organizations had steadily deteriorated since the interim service charge was initially requested and that the continued application of the surcharge was urgently needed. (Annexed as Exhibit L).

20. On July 2, 1970 the SEC announced that the Rate Structure Hearings, originally convened on July 1, 1968, would be reconvened on July 13, 1970 to receive evidence on the need to extend the interim service charge. In its announcement, the SEC stated that it would not act to terminate the service charge pending the outcome of the hearings on its extension.

21. On July 16, 1970, the Amex transmitted to the SEC the results of a new survey of member organizations supplementing the results of the survey conveyed in its March 26 letter which first demonstrated the need for an interim service charge. (Annexed as Exhibit M). The results of the new survey revealed that the overwhelming majority of member organizations surveyed had continued to suffer substantial losses even with the additional income provided by the service charge.

22. The SEC continued its supervision of the financial state of the securities industry and did not revoke its approval of the interim service charge. The interim service charge was repealed in April, 1972, when Amex Rule 396 was changed to prohibit the imposition of any charge in excess of the prescribed commission rates presently in effect.

23. On June 30, 1970, as a result of its own studies on the commission rate structure, the NYSE submitted to the SEC a proposed permanent schedule or "rate package" to replace the interim commission rates then in effect. On July 2, 1970 the SEC announced that its Rate Structure Hearings would reconvene on July 20, 1970 to receive testimony and other relevant data concerning the NYSE's proposed new rate package. (Exchange Act Release No. 8924, dated July 2, 1972, Annexed as Exhibit N).

24. On July 16, 1970, the Amex submitted to the SEC its views "as to the importance of the commission rate-making process, and the relationship of that process to the functioning of the exchange markets and the regulation of

securities markets." (Annexed as Exhibit O). In its submissions the Amex expressed its support of the procedures followed by the NYSE in developing its June 30 commission rate schedule proposal.

25. On March 17, 1971, the SEC transmitted to the Amex copies of correspondence which had passed between the Commission and the NYSE relating to the NYSE's June 30 commission rate proposal. (Annexed as Exhibit P.) On October 22, 1970 the SEC had advised the NYSE that "fixed charges for portions of orders in excess of $100,000 are neither necessary nor appropriate." On February 10, 1971 the SEC directed the NYSE to take action to implement, by April, 1971, negotiated commission rates on institutional-sized orders, but agreed to accept $500,000 as the breakpoint for the negotiated rates. On March 9, 1971, the NYSE responded that the April 1 deadline did not offer sufficient time to review the SEC's proposal and implement a constitutional amendment. The SEC on March 10, 1971 reiterated its April 1 deadline, and warned the NYSE that the maintenance of minimum commission rates on portions of orders above the $500,000 breakpoint after the deadline "would be unreasonable and could be contrary to the Exchange Act."

26. In a letter to the SEC on March 26, 1971, President Saul of the Amex stated that "in view of the Commission's position, the Exchange is obliged to recommend appropriate revisions to its Constitution and Rules to eliminate fixed minimum commissions on that portion of an order in excess of $500,000." (Annexed as Exhibit Q)

27. Pursuant to a vote of the membership, the amendments to the Amex's Constitution providing for negotiated commission rates on that portion of orders in excess of $500,000 became effective on May 3, 1971.

28. The SEC consistently maintained that the $500,000 breakpoint for negotiated commission rates did not represent a final determination as to commission rate

structures, and that the Commission would review the impact of the changes. Accordingly, to allow the SEC and the exchange to observe the workings of competitive rates, on May 3, 1971 the Amex effectuated Rule 398, which required members to report executions of orders exceeding $500,000. (A copy of Amex letter to SEC, dated April 28, 1971, transmitting proposed Rule 398 is annexed as Exhibit R).

29. On February 2, 1972, the SEC advised in its "Statement on the Future Structure of the Securities Markets" that the breakpoint for portions of orders subject to negotiated commission rates should be lowered from $500,000 to $300,000. The Commission directed the NYSE to take the required action implementing such a change within 90 days. In a letter on March 19, 1972 the SEC advised the Amex that it should begin to draft rule changes providing for a lowering of the breakpoint for negotiated commission rates to $300,000. (Annexed as Exhibit S). The Amex replied by letter on March 28, 1972, submitting to the SEC, pursuant to SEC Rule 17(a)-8, copies of proposed rule changes providing for a lowering of the breakpoint to $300,000. (Annexed as Exhibit T).

30. On April 24, 1972, pursuant to a vote of its membership, the Amex amended its Constitution to adopt a commission rate schedule providing for cost-related discounts for volume transactions and negotiated commission rates on that portion of orders in excess of $300,000. Concurrently, provisions for the earlier volume discount and the interim service charge were repealed.

31. The existing commission rate structure of the Amex is the subject of continuous study by the exchange and the SEC. The SEC not determined that the Amex's present commission rates represent a final resolution of the commission rate structure. Of particular interest to the SEC and the Amex in their continuing observation of the impact of existing commission rates, is the advisability of

lowering the breakpoint between minimum and negotiated commission rates below its present $300,000 level.

32. The plaintiff in this action, Richard A. Gordon, has never applied for, or been denied application for, membership in the Amex during the past six years. This information is based on an examination of Amex records. It was not necessary to examine the records to ascertain whether the Independent Investors protective League has ever applied for membership in the Amex, since only individuals are eligible for Amex membership.

s/H. Vernon Lee, Jr.
H. VERNON LEE, JR.

Sworn to
December 4th, 1972

EXHIBIT "A"

American Stock Exchange
Constitution
Article VI, Revised to August 1, 1972

ARTICLE VI

Commissions and Charges

General Rule

Sec. 1. *** Commissions shall be charged and collected upon the execution of all orders for the purchase or sale, for account of others, of securities, including securities "when, as and if issued", listed or admitted to unlisted trading upon the Exchange, and these commissions shall be at rates not less than the rates in this Article prescribed, and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether or not such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or by a rule adopted by the Board of Governors, shall be given, paid or allowed directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member of the Exchange or member firm or member corporation. No member, member firm or member corporation shall make a proposition for the transaction of business at less than the minimum rates of commission prescribed in this Article. No member, member firm or member corporation shall, in consideration of the receipt of business in securities dealt in on the Exchange and at the direct or indirect request of a non-member or by direct or indirect arrangement with a non-member, make any payment or give up any work or give up all or any part of any commission or other property to which such member, member

firm or member corporation is or will be entitled.***

Transactions on another exchange.

Notwithstanding the provisions of this Article, any member of the Exchange or member firm or member corporation which is a member or registered firm or corporation of another exchange located in the United States or Canada, or registered with a Canadian exchange as being entitled to a return of commission from members of such exchange, may in respect of transactions made on such other exchange charge the rates of commission prescribed by such other exchange.

Amendment.

*** November 1, 1968, effective December 5, 1968.

Schedule of Stock Commissions

Sec. 2. Commissions shall be as follows:

Non-Member rates

(a) The minimum commission rates to non-members on stocks, rights and warrants (hereinafter referred to as stocks), shall be as follows:

On 100 share orders

(1) On each order for 100 shares, on stocks selling at $1.00 per share and above, commissions shall be based upon the amount involved in the order and, subject to the provisions of subsections (f), (h) and (l) of this Section 2, shall be not less than the rates hereinafter specified:

Amount Involved in the Order	Minimum Commission
$100—but under $800	2.0% of money involved + $ 6.40
$800—but under $2,500	1.3% of money involved + $12.00
$2,500—and above	0.9% of money involved + $22.00

Notwithstanding the foregoing:

(i) When the amount involved in an order is less than $100, the minimum commission shall be as mutually agreed.

(ii) The minimum commission on an order for 100 shares shall not exceed $65.00

Multiple round lot orders

(2) On each multiple round lot order for 200 shares or more, on stocks selling at $1.00 per share and above, commissions shall be based upon the amount involved in the order and, subject to the provisions of subsections (f), (h) and (l) of this Section 2, shall be not less than the rates hereinafter specified:

Amount Involved in the Order	Minimum Commission
$100—but under $2,500	1.3% of money involved + $12.00
$2,500—but under $20,000	0.9% of money involved + $22.00
$20,000—but under $30,000	0.6% of money involved + $82.00
$30,000—to and including $300,000	0.4% of money involved + $142.00

Plus a charge for each round lot of 100 shares within the order as follows:

First to tenth round lot	$6.00 per round lot
Eleventh round lot and above	$4.00 per round lot

Notwithstanding the foregoing:

(i) When the amount involved in an order is less than $100, the minimum commission shall be as mutually agreed.

(ii) The minimum commission per round lot shall not exceed the single round lot commission computed in accordance with the provisions of paragraph (i) of subsection (a) of this Section 2.

Odd Lot Orders

(3) On any odd lot order, commissions shall be based upon the amount involved in the order and shall be not less than the rates specified in paragraph (1) of subsection (a) of this Section 2, less $2.00 subject to the provisions of subsections (f), (h) and (l) of this Section 2.

Notwithstanding the foregoing:

(i) When the amount involved in an odd lot order is less than $100, the minimum commission shall be as mutually agreed.

(ii) The minimum commission on an odd lot order shall not exceed $65.00.

(iii) When one or more odd lot orders plus one or more round lot orders are executed in the same security, on the same day, for the same account, on the same side of the market, the commission(s) on such odd lot order(s) shall not exceed the commission which would be chargeable with respect to the nearest round lot in excess of such odd lot order(s).

(4) On that portion of an order involving an amount of $500,000 or less, on stocks selling below $1 per share, commissions shall be based upon the amount involved in the order and shall be not less than the rates hereinafter specified:

Amount Involved in the Order	Minimum Commission
$0—but under $1,000	8.4% of money involved
$1,000—but under $10,000	5.0% of money involved + $34.00
$10,000—and above	4.0% of money involved + $134.00

Notwithstanding the foregoing, when the amount involved in an order is less than $100, the commission shall be as mutually agreed.

Floor brokerage and clearance rates

(b) The minimum commission rates to regular and associate members on stocks, rights and warrants (hereinafter referred to as stocks) shall be based on the number of round lots and the price of the shares involved in each round lot order as follows:

(1) Regular member floor brokerage and clearance rates—

Price Per Share	First and Second Round Lot: Floor Brokerage Only Rate	First and Second Round Lot: Combined Floor Brokerage and Clearance Rate	Third Through Tenth Round Lot: Floor Brokerage Only Rate	Third Through Tenth Round Lot: Combined Floor Brokerage and Clearance Rate	Eleventh Round Lot and Over: Floor Brokerage Only Rate	Eleventh Round Lot and Over: Combined Floor Brokerage and Clearance Rate
1/256 of $1 and above, but under 3/256 of $1	$0.05	$0.08	$0.04	$0.07	$0.03	$0.05
3/256 of $1 and above, but under 1/4 of $1	0.30	0.50	0.25	0.41	0.20	0.32
1/4 of $1 and above, but under 1/2 of $1	0.65	1.05	0.55	0.90	0.45	0.75
1/2 of $1 and above, but under $1	1.10	1.80	1.00	1.60	0.90	1.45
$1 and above, but under $4	1.50	2.45	1.20	1.95	1.10	1.80
$4 and above, but under $8	2.60	4.20	2.10	3.40	1.90	3.10
$8 and above, but under $12	3.15	5.10	2.50	4.05	2.05	3.30
$12 and above, but under $16	3.40	5.50	2.80	4.55	2.50	4.05
$16 and above, but under $20	3.85	6.25	3.05	4.95	2.70	4.35
$20 and above, but under $30	4.10	6.65	3.30	5.35	2.95	4.80
$30 and above, but under $40	4.35	7.05	3.50	5.65	3.15	5.10
$40 and above, but under $50	4.65	7.55	3.75	6.10	3.35	5.45
$50 and above	4.95	8.00	3.95	6.40	3.55	5.75

(2) Associate member floor brokerage and clearance rates—

Price Per Share	First and Second Round Lot: Floor Brokerage Only Rate	First and Second Round Lot: Combined Floor Brokerage and Clearance Rate	Third Through Tenth Round Lot: Floor Brokerage Only Rate	Third Through Tenth Round Lot: Combined Floor Brokerage and Clearance Rate	Eleventh Round Lot and Over: Floor Brokerage Only Rate	Eleventh Round Lot and Over: Combined Floor Brokerage and Clearance Rate
1/256 of $1 and above' but under 3/256 of $1	$0.06	$0.09	$0.06	$0.09	$0.04	$0.06
3/256 of $1 and above, but under 1/4 of $1	0.40	0.60	0.30	0.45	0.20	0.30
1/4 of $1 and above, but under 1/2 of $1	0.80	1.20	0.70	1.05	0.60	0.90
1/2 of $1 and above, but under $1	1.40	2.10	1.20	1.80	1.10	1.65
$1 and above, but under $4	3.25	4.20	2.60	3.35	2.40	3.10
$4 and above, but under $8	5.65	7.25	4.60	5.90	4.15	5.35
$8 and above, but under $12	6.85	8.80	5.45	7.00	4.45	5.70
$12 and above, but under $16	7.40	9.50	6.10	7.85	5.45	7.00
$16 and above, but under $20	8.40	10.80	6.65	8.55	5.90	7.55
$20 and above, but under $30	8.95	11.50	7.20	9.25	6.45	8.30
$30 and above, but under $40	9.50	12.20	7.65	9.80	6.85	8.80
$40 and above, but under $50	10.05	13.05	8.20	10.55	7.30	9.40
$50 and above	10.80	13.85	8.60	11.05	7.75	9.95

Notwithstanding the foregoing rates specified in this subsection (b), when the amount involved in an order is less than $100, the commission shall be as mutually agreed.

When the amount involved in an order exceeds $300,000, the minimum commission to be charged pursuant to this subsection (b) shall apply only to the maximum number of round lot transactions involving an aggregate amount not in excess of $300,000.

Registered specialists' floor rates

(c) A registered specialist shall charge, as Floor rates for the execution of members' orders in stocks rights and warrants (hereinafter referred to as stocks) given him on the Floor of the Exchange personally by a regular member, by a member representative, or by an employee of the Exchange, in writing and signed, the following commission based on the number of round lots and the price of the shares involved in each round lot order. These commissions shall apply only to transactions when the principal's name is given up at the time of such transactions.

	Rate per round lot		
Price Per Share	First and Second Round Lot	Third Through Tenth Round Lot	Eleventh Round Lot and Over
1/256 of $1 and above, but under 3/256 of $1	$0.04	$0.03	$0.02
3/256 of $1 and above, but under 1/4 of $1	0.25	0.20	0.15
1/4 of $1 and above, but under 1/2 of $1	0.50	0.40	0.35
1/2 of $1 and above, but under $1	$0.80	$0.75	$0.65
$1 and above, but under $4	1.10	0.90	0.80
$4 and above, but under $8	1.95	1.55	1.40
$8 and above, but under $12	2.35	1.90	1.55
$12 and above, but under $16	2.55	2.10	1.90
$16 and above, but under $20	2.90	2.30	2.05
$20 and above, but under $30	3.05	2.50	2.20
$30 and above, but under $40	3.25	2.65	2.35
$40 and above, but under $50	3.50	2.80	2.50
$50 and above	3.70	2.95	2.65

Notwithstanding the above rates, when the amount involved in an order is less than $100, the commission shall be as mutually agreed.

When the amount involved in an order exceeds $300,000, the prescribed commission to be charged pursuant to this subsection (c) shall apply to the maximum number of round lot transactions involving an aggregate amount not in excess of $300,000.

Schedule of Bond Commissions

(d) The Minimum Commission Rates on Bonds and Notes shall be as follows:

To Regular Members, to Associate Members and to Non-Members

	Give-up	Clearance	Non-Members
All bonds or Notes selling at less than 1, per $1,000 par value	$25	$ .50	$ .75
All Bonds or Notes selling at 1 and under 10, per $1,000 par value	.37½	.62½	1.25
All Bonds or Notes having 6 months to and including 5 years to run, selling between 96 and 110, per $1,000 par value	.50	.80	1.25
Less than six months to run	Mutual Agreement	Mutual Agreement	Mutual Agreement
All Bonds or Notes having 5 years or less to run selling at 10 and under 96 and over 110, per $1,000 par value	.75	1.25	2.50
All Bonds or Notes having more than 5 years to run selling at 10 or over, per $1,000 par value	.75	1.25	2.50
Bonds called for redemption having 6 months to and including 12 months to run and having a current market price of not less than 96% or more than 110% of their redemption price per $1,000 par value	.50	.80	1.25
Less than 6 months to run	Mutual Agreement	Mutual Agreement	Mutual Agreement
Bonds called for redemption having 6 months to and including 12 months to run and having a current market price of less than 96% or more than 110% of their redemption price per $1,000 par value	.75	1.25	2.50

Specialists

All(e) The Specialists Floor Rates on Bonds and Notes shall be as follows:

All Bonds or Notes selling at less than 1	$.10 per $1,000 par value
All Bonds or Notes selling at 1 and under 10	$.15 per $1,000 par value
All Bonds or Notes having 6 months to and including 5 years to run, selling between 96 and 110, inclusive	$.20 per $1,000 par value
Less than 6 months to run	$.10 per $1,000 par value
All Bonds or Notess having 5 years or less to run selling at 10 and under 96 and over 110	$.30 per $1,000 par value
All Bonds or Notes having more than 5 years to run selling at 10 or over	$.30 per $1,000 par value
Bonds called for redemption having 6 months to and including 12 months to run and having a current market price of not less than 96% or more than 110% of their redemption price	$.20 per $1,000 par value
Less than 6 months to run	$.10 per $1,000 par value
Bonds called for redemption having 6 months to and including 12 months to run and having a current market price of less than 96% or more than 110% of their redemption price	$.30 per $1,000 par value

Definition of an order

(f) For the purpose of this Section 2

(1) A round lot order shall be deemed to include either all purchases or all sales for one account, of a single security, on the same day, amounting to 100 shares or any multiple thereof, irrespective of the unit of trading in the stock. This definition applies whether the order is received from a non-member, allied member, member, member firm or member corporation.

(2) An odd lot order shall be deemed to include either all purchases or all sales of one account, of a single security, on the same day, pursuant to a single order amounting to less than 100 shares, irrespective of the unit of trading in the stock. Any odd lot order shall be deemed to be a separate order whether combined with a round lot order or standing alone. This definition applies whether the order is received from a non-member, allied member, member, member firm or member corporation.

(3) With respect to stocks in which the unit of trading is less than 100 shares, the minimum commission rates to be charged to regular and associate members for Floor brokerage and clearance pursuant to subsection (b) of this Section 2 and the prescribed commission to be charged by registered specialists as Floor rates pursuant to subsection (c) of this Section 2 shall be determined as follows:

(i) All purchases or all sales for one account, of a single security, on the same day, amounting to 100 shares or any multiple thereof, shall be treated as a round lot order as defined in paragraph (1) of this subection (i) and the applicable round lot commission rate shall be charged.

(ii) The Commission to be charged on that portion of an order which involves a number of shares equal to the unit of trading or any multiple thereof but less than 100 shares, shall be an amount equal to that proportion of the next round lot rate, after first applying subparagraph (i) of this paragraph (3), which such number of shares bears to 100.

Determining amount involved in an order

(g) In determining the amount involved in an order, commissions and taxes shall be disregarded.

Limitation on minimum commissions

(h) Notwithstanding the rates prescribed in paragraphs (1) and (2) of subsection (a) of this Section 2, when the amount involved in a single order exceeds $300,000, the minimum commission to be charged pursuant to those paragraphs shall apply only to the maximum number of round lot transactions involving an aggregate amount not in excess of $300,000. The Exchange shall from time to time prescribe the procedures to be followed in computing commissions pursuant to this Article.

Special Rates

(i) Notwithstanding the other provisions of this Article, when Rights or Warrants are admitted to dealings upon the Exchange whether on an issued or when issued basis, and when other securities are admitted to such dealings on a when issued basis the Board of Governors may determine special minimum rates of commission on any and all transactions in such rights, warrants or other securities. Such special rates so prescribed or provided by the Board of Governors shall be deemed to be the rates prescribed in this Article. Unless special rates have been so determined the minimum rates of commission prescribed in this Article shall apply.

(j) The minimum clearing charges to members, member firms and member corporations applicable to stock, warrant and right transactions effected by them for their own account shall be as follows:

Round lots: $1.00 a share and over—$3.00 for combined receipt and delivery
Under $1.00 a share—as mutually agreed
Odd lots: Ten shares and over—$1.00 on each side
Under ten shares—as mutually agreed
Warrants: Same as stocks
Rights: As mutually agreed.

Where any such transaction involves a purchase or sale made at one time from a single seller or buyer and involves an amount in excess of $300,000, the minimum rates specified above shall apply only with respect to that portion of such purchase or sale not in excess of $300,000.

Supervised order

(k) When an order is supervised by a regular member, not a partner in or a holder of voting stock in the particular member firm or member corporation whose business he is supervising, the specialist to whom the order is given, either by the member supervising such order or by the telephone clerk of the specific firm or corporation whose name is on the order, shall bill such member supervising the order the specialists' Floor rate and such member shall, in turn bill the firm or corporation whose name is on the order slip the regular member give-up rate.

Public obligations and called securities

(l) Commission rates to members or non-members may be charged, as mutually agreed, on obligations of the United States, Puerto Rico, Philippine Islands and States, Territories and Municipalities therein, and on securities which, pursuant to call, are to be redeemed within twelve months, unless commission rates on any or all such securities are prescribed in this Section or by the Board of Governors.

Commissions on small orders

(m) Except as otherwise provided by Rule adopted by the Board of Governors, commissions shall be charged and collected at the rates prescribed in this Section 2 on the execution of any small orders or for small accounts.

Broker-Dealer Discount

(n) A member, member firm or member corporation may, on orders which he or it receives from a non-member broker-dealer whose principal place of business is in one of the United States, the District of Columbia or the Commonwealth of Puerto Rico, and which is a member of the National Association of Securities Dealers, Inc. or is subject to Sec. 15(b)(8) of the Securities Exchange Act of 1934 for the account of any customer whose account is carried by such broker-dealer, or is introduced by such broker-dealer to such member, member firm or member corporation, allow not in excess of a 40% discount from the commission computed, in accordance with the provisions of subsection (a) of this Section 2, provided that the primary purpose of such non-member broker-dealer and of any parent of such non-member broker-dealer is the transaction of business as a broker or dealer in securities in one of the United States, the District of Columbia or the Commonwealth of Puerto Rico within the meaning of Section 2(d) of Article IV, and the rules thereunder and, provided, further, that such non-member broker-dealer is subject to an agreement in writing as provided by rule adopted by the Board of Governors, which agreement has not been terminated, containing such provisions as may be required from time to time by rule adopted by the Board of Governors and providing that any such discount so allowed shall be retained by such non-member broker-dealer free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect, to or for the benefit of any customer of such non-member broker-dealer except that with respect to any

order for the account of a customer whose account is introduced to such non-member broker-dealer by a second non-member broker-dealer, the non-member broker-dealer may allow all or any portion of such discount to such second non-member broker-dealer provided that the second non-member broker-dealer would qualify for a discount under the provisions hereof had it introduced its customer's account directly to the member, member firm or member corporation and is itself subject to a similar agreement.

The provisions of this subsection (n) shall expire one year after the effective date hereof, unless extended for such period of time, or from time to time, as shall be determined by the Board of Governors.

Amended effective August 26, 1958, March 30, 1959, October 19, 1959, January 22, 1960, September 4, 1962, July 26, 1963, December 5, 1968, February 2, 1971, May 3, 1971, April 3, 1972 and April 24, 1972.

Commissions to Firms and Corporations

Sec. 3. †*A member firm having as a general partner a regular or associate member of the Exchange, and a member corporation having either a regular member who is a holder of voting stock therein and is actively engaged in its business and devotes the major portion of his time thereto or an associate member who is a director or executive officer thereof, shall be entitled to have its business transacted at the rates of commission prescribed for such member.*†

Branch offices

The privilege provided for in this Section shall extend to a branch house or branch office only when conducted under the same name as the parent firm and only when the partners and their respective interests therein are identical with the partners and their respective interests in the

parent firm, or when conducted as part of the business of the member corporation.

Members who are special partners or are not directors or executive officers

† A member who is a special partner in a firm does not thereby confer any of the privileges of the Exchange on such firm, and a member who is not a holder of voting stock of a regular member corporation actively engaged in its business and devoting the major portion of his time thereto or who is not a director or executive officer of an associate member corporation does not confer any of the privileges of the Exchange on such corporation, and on all business done by him for such firm or corporation, commissions must be charged and collected at rates not less than the rates prescribed in this Article.†

Commissions, at the rates prescribed in this Article for non-members, shall be charged and collected on business done for the account of allied member and non-member partners of member firms, allied member and non-member stockholders, directors or officers of member corporations and joint-accounts to which an allied member or non-member is a party.

Amendments.

* Amended January 16, 1958, effective May 1, 1958.
† Amended effective February 2, 1971.

Commissions to Suspended Member

Sec. 4. *†**(a) A regular or associate member suspended under the provisions of Section 3 of Article V, who has not been declared ineligible for reinstatement and who has not also been suspended under the provisions of Section 4 or Section 5 of Article V, may in the discretion of the Board of Governors have his business transacted at member's rates.

††**(b) On the application of a member organization which has been suspended under the provisions of Section 3

of Article V, but has not been declared ineligible for reinstatement and has not been suspended under the provisions of Section 4 or Section 5 of Article V, or on the application of a member organization whose only general partner who was a regular or associate member of the Exchange, or whose only voting stockholder actively engaged in its business and devoting the major portion of his time thereto who was a regular member of the Exchange, or whose only director or executive officer who was an associate member of the Exchange, has been suspended under the provisions of Section 3 of Article V, but has not been declared ineligible for reinstatement and has not been suspended under the provisions of Section 4 or Section 5 of Article V, the Board of Governors in its discretion may in either such case permit such member organization to have its business transacted at member's rates during all or such portion of such suspension as the Board may determine and under such conditions as the Board may fix. The Board may in its discretion and during such period of time and under such terms and conditions as it may determine permit a former member organization suspended under the provisions of Section 3 of Article V to continue to have its business transacted at member's rates, notwithstanding the fact that the sole regular member of such member organization has disposed of his regular membership or the sole associate member of such member organization has ceased to be an associate member, provided that the transactions with respect to which such member's rates are charged are liquidating transactions or are reasonably necessary to permit such firm or corporation to wind up its business or to transfer the account of a customer.††

††**(c) On the application of a member organization which has not itself been suspended under the provisions of Section 4 or Section 5 of Article V but whose only general partner who was a regular or associate member of the Exchange, or whose only voting stockholder actively engaged in its business and devoting the major portion of

his time thereto who was a regular member of the Exchange, or whose only director or executive officer who was an associate member of the Exchange, has been suspended under the provisions of Section 4 or Section 5 of Article V, the Board of Governors in its discretion may permit such member organization to have its business transacted at member's rates during all or such portion of the suspension of such regular or associate member as the Board may determine and under such conditions as the Board may fix, and so long as such suspended regular or associate member remains a general partner, voting stockholder, director or executive officer of such member organization.**†*††

Amendments.
* Amended January 16, 1958, effective May 1, 1958.
† Amended effective September 4, 1962.
** Amended effective November 19, 1969
†† Amended effective February 2, 1971.

Board May Prescribe Service Charges

Sec. 5. Members of the Exchange, member firms and member corporations shall make and collect, in addition to minimum prescribed commissions, such other minimum charges with respect to accounts and services as the Board of Governors may from time to time prescribe. Except as may be specifically permitted by a rule adopted by the Board of Governors, such charges shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect, and no bonus or percentage of such charges, whether such charges be minimum charges prescribed by the Board or greater charges, shall be given, paid, or allowed, directly or indirectly, or as a salary or portion of a salary to a clerk or to any member of the Exchange, member firm or member corporation, or to any other person, firm or corporation for business sought or procured for any member of the Exchange, a member firm or a member corporation.

Commission—Individual Regular Member in War Service

Sec. 6. *Notwithstanding any other provision of this Article, the Board of Governors may permit a member, member firm or member corporation to pay to any regular member, who is actively engaged in any military, naval or other public service incident to the defense of the United States or of any nation which is then allied or associated with the United States, amounts not exceeding 50% of the minimum commissions received from time to time by such member, member firm or member corporation for the execution of orders for the purchase or sale of securities which would otherwise have been executed by such absent member in the usual course of his business. In the exercise of the discretion herein granted, the Board of Governors may condition or restrict or may withdraw or deny any such permission.*

Amendments.
*Amended effective September 4, 1962.

Commission—Member Firm with Sole Regular Member General Partner, or Member Corporation with Sole Regular Member Director, in War Service

Sec. 7. †* Notwithstanding any other provisions of this Article, when a regular member of the Exchange who is the sole regular member general partner in a member firm or the sole regular member voting stockholder of a member corporation, is actively engaged in any military, naval or other public service incident to the defense of the United States or of any nation which is then allied or associated with the United States, the Board of Governors may permit an agreement between such member firm or member corporation and another regular member or regular member firm or regular member corporation, providing in substance that, on transactions executed on the Floor of

the Exchange by such other regular member or regular member firm or regular member corporation for such firm or corporation, the commissions chargeable by the executing member or member firm or member corporation shall be less than the minimum commissions otherwise prescribed as applicable to transactions effected on the Floor of the Exchange for other members where a principal is given up, provided that (1) such commissions so chargeable shall not be less than 50% of the minimum commissions so prescribed, (2) the transactions with respect to which such reduced commissions are charged were executed at a time when the regular member in such service was absent from the Floor solely by reason of such service, (3) that such transactions would otherwise in general have been effected by such absent member as a part of his usual business, and (4) that any such agreement has been submitted to and approved by the Exchange.*†

Amendments.

* Amended effective September 4, 1962.

† Amended effective February 2, 1971.

EXHIBIT B

American Stock Exchange
Office Rules
Section 6. Revised to August 1, 1972

Section 6. Collection of Commissions and Fees

Non-Member Order Executed and Given Up

Rule 380. In transactions where orders are received from a non-member, and the member, member firm or member corporation executing the order is directed to give up another member, member firm or member corporation the responsibility for collecting the full commission shall rest with the member, member firm or member corporation settling the transaction.

Member Order Executed and Given Up

Rule 381. In transactions where orders are received from a member, member firm or member corporation and a clearing firm or corporation is given up, the responsibility for collecting the full commission shall rest with the clearing firm or corporation and it shall be the duty of the member, member firm or member corporation executing such orders to report the transactions to the clearing firm or corporation and to render his bill therefor at the rates specified. A member, member firm or member corporation who executes an order for a member, member firm or member corporation and clears the security himself must charge the rates specified.

Execution of Domestic Customer's Orders in Foreign Market

Rule 382. When a member, member firm or member corporation accepts an order, from a customer within the continental United States or Canada, for the purchase or sale of a security admitted to dealings on the Exchange and

causes the same to be executed in a market outside the continental United States or Canada, during the time the Exchange is open for the transaction of business, such member, member firm or member corporation shall charge and collect, in addition to any commission payable to the party or parties executing such order in said market, a sum not less than the prescribed minimum member or non-member commission rate, as the case may be.

Clearance of Domestic Customer's Transaction in Foreign Market

Rule 383. When a member, member firm or member corporation accepts and clears, for a customer within the continental United States or Canada, a transaction arising from a purchase or sale of a security admitted to dealings on the Exchange effected by said customer in a market outside the continental United States or Canada, during the time the Exchange is open for the transaction of business, such member, member firm or member corporation shall charge and collect, in addition to any commission payable to the party or parties executing such transaction, a sum not less than the specified minimum member or non-member commission rate, as the case may be.

Securities Received or Delivered on Privilege

Rule 384. When Securities are received or delivered for a non-member or an allied member on a privilege, the specified commission must be charged.

Amendments.
April 3, 1958, effective May 1, 1958.

Mutual Agreement Clearing Charge on Service to Regular Member

Rule 385. When a member, member firm or member corporation receives and delivers bonds for a regular

member, the clearing charge for said service may be a matter of mutual agreement based upon a fixed rate for each one thousand dollars of bonds; the payment of a certain sum of money for said service for any period of time is forbidden.

Amendments.
October 1, 1959, effective October 19, 1959.

Commissions on Commodity Business

Rule 386. No member, member firm or member corporation shall, without charging the customary commission, transact or offer to transact for any customer who is dealing in securities dealt in on the Exchange, any business in commodities.

Bunched Orders

Rule 387. The execution of "bunched" orders, without charging the required commission, is forbidden.

Reverse Transactions

Rule 388. No member, member firm or member corporation shall make any transaction "over the counter" in securities dealt in on the Exchange for his own account or for the account of his member firm or a partner thereof or for his regular member corporation or a stockholder therein or for his associate member corporation or for any account in which either he or they have a direct or indirect interest, and a reverse operation upon the Exchange at or about the same time, wherein the difference between the purchase and sale prices is less than the recognized commission on such a purchase or sale.

Clearance of Commissions

Rule 389. Unless otherwise agreed by the parties concerned, all payments between members of the Exchange on

account of commissions on business sent to principals given up shall be made through the American Stock Exchange Clearing Corporation as provided by its By-Laws and Rules.

Assumption of Loss Prohibited

Rule 390. No member shall assume for his owc account or for the account of his member firm or member corporation, a contract made for a customer, if a loss to the customer has been established or ascertained, unless the contract was made by mistake or unless the consent of the Exchange has first been obtained.

Amendments.
September 6, 1962.

Granting of Special Advantages to Customer Prohibited

Rule 391. Any agreement or arrangement between a member, member firm or member corporation and a customer, whereby special and unusual rates of interest are given or money advanced upon unusual terms, with intent to give special or unusual advantage to such customer, for the purpose of securing his business, is forbidden.

Interest on Short Sales

Rule 392. An allowance for interest on short sales of stock shall not be more than the loan market rates for the stocks borrowed or used for such short sales.

Securities and Exchange Commission Registration Fee

Rule 393. There shall be paid to the Exchange by each member, member firm or member corporation in such manner and at such time as the Treasurer of the Exchange shall direct, the sum of one cent for each $500 or fraction

thereof of the dollar volume of the sales upon the Exchange of securities (whether or not cleared by the American Stock Exchange Clearing Corporation) cleared by such member, member firm or member corporation, and any such member, member firm or member corporation required by this rule to pay any sum to the Exchange in respect to any sale upon the Exchange, shall charge and collect from the person for whom he was acting in making such transaction the sum of one cent for each $5.00 or fraction thereof of the dollar amount involved in such transaction. The monies so paid to the Exchange shall be paid to the Securities and Exchange Commission as the registration fee imposed upon the Exchange by the provisions of the Securities Exchange Act of 1934.

Receipt or Delivery of Non-Member Securities Against Payment

Rule 394. When a member or member organization, in connection with a transaction made by a non-member or allied member off the Exchange, receives into or delivers out of the account of the non-member or allied member against payment securities dealt in on the Exchange, the prescribed non-member commission shall be charged.

Amendments.
April 3, 1958, effective May 1, 1958.
July 22, 1965.

Commissions on Rights and Warrants

Rule 395. Pursuant to Section 2, Paragraph (i) of Article IV of the Constitution, unless otherwise determined by the Board of Governors, on rights and warrants which are admitted to dealings upon the Exchange, whether on an issued or unissued basis, and which are selling below 50 cents per right or warrant, the following special rates of commission shall apply:

(1) On business for non-members or allied members, including joint account transactions in which any such person is interested, the commission may be as mutually agreed.

(2) On business for regular and associate members:

Price per share	Rate per 100 Shares		
	Specialist	Give-up	Clearance
1/256 of $1	$.01	$.05	$.05
1/128 of $1	.02	.10	.10
1/64 of $1 but under 2/32 of $1	.05	.10	.20
2/32 of $1	.05	.10	.20
over 2/32 of $1 but under 4/32 of $1	.05	.10	.20
4/32 of $1 but under 8/32 of $1	.13	.25	.50
8/32 of $1 but under 1/2 of $1	.13	.25	.50

Notwithstanding the foregoing, when the amount involved in a transaction is less than $100, the commission may be as mutually agreed.

Amendments.
Adopted effective December 7, 1961.
September 6, 1962.

Small Accounts

Rule 396. No member organization which introduces or carries the accounts of customers who purchase or sell small amounts of stock shall impose any limitation of any kind on the size or frequency of customer orders in such accounts or the size of such accounts, unless such limitation was generally imposed prior to April 1, 1969. With respect to the execution of any small order for the purchase or sale of any security admitted to dealings on the Exchange, no member organization shall impose any fee, commission or other charge on any customer in excess of the commission prescribed in Article VI, Section 2(a) of the Constitution.

Amendments.
April 3, 1972.

Computation of Commission on Stocks

Rule 397. The minimum commission required to be charged under Section 2 of Article VI shall be computed on the basis of the lowest priced executions first.

Adopted.
May 3, 1971.

Reports of Executions of Orders Exceeding $500,000

Rule 398. Promptly following the 10th day of each calendar month each member or member organization shall report the following information to the Exchange with respect to each order executed, either as principal or agent, during the preceeding calendar month for the purchase or sale of any stock admitted to dealings upon the Exchange, where the amount involved in such order exceeds $500,000:

(1) the name of the stock;

(2) whether the customer of the member or member organization purchased or sold the stock. Where the member or member organization had all or a portion of both sides of the transaction this should be indicated and the amount on each side should also be indicated:

(3) whether the member or member organization acted as agent or principal, or both, and the number of shares on each side of the transaction with respect to which the member or member organization so acted;

(4) the date of execution;

(5) the market or markets where executed;

(6) the number of shares in the order and the number of shares in each execution included within the order;

(7) the commission or commissions charged on each portion of the order; and,

(8) such other information as the Exchange may from time to time require.

For the purpose of this rule, an order shall be as defined in Article VI, Section 2(i)(2) of the Constitution.

Adopted.
May 3, 1971.

Qualifying for Discount

Rule 399. (a) No discount shall be allowed by any member or member organization to any non-member broker-dealer as permitted by Article VI, Section 2, paragraph (n) of the Constitution, unless at the time the non-member broker-dealer is subject to an agreement in writing with the Exchange providing:

(1) Any discount allowed to such non-member broker-dealer as permitted by the said paragraph (n) shall be retained by such non-member broker-dealer free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect, to or for the benefit of any customer of such non-member broker-dealer, except that with respect to any order for the account of a customer whose account is introduced to such non-member broker-dealer by a second non-member broker-dealer (hereinafter called "introducing non-member"), the non-member broker-dealer may allow all or any portion of such discount to the introducing non-member provided that the introducing non-member would qualify for a discount under the provisions of said paragraph (n) had it introduced its customer's account directly to a member or member organization of the Exchange, and provided further that the introducing non-member broker-dealer is itself subject to an agreement in writing with the Exchange as provided under Section (b) of this Rule. For the purpose of this Rule, the term "customer" shall be defined as that

term is defined in Section 6(c)(2((A)(ii) of the Securities Investors Protection Act of 1970;

(2) Such non-member broker-dealer shall not receive any such discount except with respect to orders executed for the accounts of bona fide customers of such non-member, whose accounts are carried by such non-member broker-dealer or are introduced by such non-member broker-dealer to the member or member organization which carries the account;

(3) Such non-member broker-dealer shall cease to be qualified to receive any such discount whenever such non-member breaches any provision of its agreement with the Exchange or whenever such non-member ceases to maintain its principal place of business in one of the United States, the District of Columbia or the Commonwealth of Puerto Rico, or ceases to be a member of the National Association of Securities Dealers, Inc. or to be subject to Section 15(b)(8) of the Securities Exchange Act of 1934 or whenever the primary purpose of such non-member and of any parent of such non-member (as defined in Rule 314) ceases to be the transaction of business as a broker or dealer in securities within the meaning of such rule. Whenever such non-member ceases to be qualified to receive any such discount such non-member shall be required to give the Exchange prompt written notice thereof;

(4) At any time and from time to time during normal business hours the Exchange shall have access to the books and records of such non-member broker-dealer at its principal place of business in order to determine compliance by such non-member with its agreement with the Exchange. Whenever any such examination by the Exchange fails to establish to the satisfaction of the

Exchange compliance by such non-member with the provisions of its agreement with the Exchange, or whenever such non-member ceases to qualify for the discount provided by Article VI, Section 2, paragraph (n) of the Constitution, the Exchange may send written notice to such non-member terminating such agreement and shall thereupon notify members and member organizations of such termination;

(5) Unless sooner terminated by such non-member or the Exchange, such agreement shall terminate whenever the provisions of Article VI, Section 2, paragraph (n) of the Constitution shall expire.

(b) No introducing non-member may receive all or any portion of any discount permitted by Article VI, Section 2, paragraph (n) of the Constitution, unless, at the time such discount is received, the introducing non-member is subject to an agreement in writing with the Exchange providing:

(1) Any such discount so received shall be retained by the introducing non-member free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect, to or for the benefit of any customer of the introducing non-member;

(2) The introducing non-member shall not receive any such discount except with respect to orders executed for the accounts of bona fide customers of the introducing non-member which accounts are carried by a non-member broker-dealer subject to an agreement with the Exchange as provided under Section (a) of the rule;

(3) The introducing non-member shall cease to be qualified to receive any such discount whenever

such non-member breaches any provision of its agreement with the Exchange or whenever such non-member ceases to maintain its principal place of business in one of the United States, the District of Columbia or the Commonwealth of Puerto Rico, or ceases to be a member of the National Association of Securities Dealers, Inc. or to be subject to Section 15(b)(8) of the Securities Exchange Act of 1934 or whenever the primary purpose of such non-member and of any parent of such non-member (as defined in Rule 314) ceases to be the transaction of business as a broker or dealer in securities within the meaning of such rule. Whenever such non-member ceases to be qualified to receive any such discount such non-member shall be required to give the Exchange prompt written notice thereof;

(4) At any time and from time to time during normal business hours the Exchange shall have access to the books and records of such introducing non-member as its principal place of business in order to determine compliance by such introducing non-member with its agreement with the Exchange. Whenever any such examination by the Exchange fails to establish to the satisfaction of the Exchange compliance by such introducing non-member with the provisions of its agreement with the Exchange, or whenever such introducing non-member ceases to qualify for the discount provided by Article VI, Section 2, paragraph (n) of the Constitution, the Exchange may send written notice to such introducing non-member terminating such agreement and shall thereupon notify members and member organizations and non-member broker-dealers subject to agreements under Section (a) of this Rule of such termination;

(5) Unless sooner terminated by the introducing non-member or the Exchange, such agreement shall terminate whenever the provisions of Article VI, Section 2, paragraph (n) of the Constitution shall expire.

* Amendments.

Adopted effective April 3, 1972.

AMERICAN STOCK EXCHANGE
SUBCOMMITTEE ON COMMISSION STRUCTURE

Memorandum

April 19, 1968

To: Members and Member Organizations
FROM: Subcommittee on Commission Structure
SUBJECT Intra-Member Commission Rates

The Subcommittee on Commission Structure has been appointed by the Board of Governors to review all aspects of the Exchange's commission rates in light of changing market conditions, costs of doing business, and needs of the investing public. As a first step in such a review, the Subcommittee on Commission Structure has examined the intra-member commission rate structure of the Exchange. The Subcommittee has been aided in its examination by a report of Haskins & Sells, a major accounting firm, engaged by the Exchange in 1965 to make a study of the intra-member commission structure and to evaluate its fairness and adequacy to each segment of the membership.

It should be emphasized that this memorandum does not cover commission rates charged to public customers.

The purpose of this memorandum is to obtain your reaction to the Subcommittee's review of the intra-member commission rate schedules and to have the benefit of your suggestions and ideas. No final decisions have been reached and suggestions will be welcomed. The purpose of this review is to strengthen the Exchange as a public marketplace and to insure an equitable division of commissions among members.

The Subcommittee feels these matters merit the most searching consideration. A suggested procedure for expressing your views in writing or in person is outlined at the end of this memorandum.

Present Intra-Member Commission Rate Schedules

The intra-member commission schedules of the Exchange cover charges by members to other members for execution on the floor and clearing of transactions. There are three intra-member rates: the first covering the execution of a transaction (the "floor brokerage" or floor "give-up" rate), the second covering both the execution and clearing of a transaction (the "clearance" rate), and the third covering the execution of orders entrusted by members to the specialist for execution (the "specialist's commission"). These rates are prescribed by the Exchange Constitution on a per round-lot basis based on share price.

American Stock Exchange clearance and floor brokerage rates have traditionally been higher than corresponding New York Stock Exchange rates. American and New York Stock Exchange floor brokerage and clearance rates for regular members are set forth in Attachment A. These differences apparently stemmed from differences in average share prices on the two exchanges when the original schedules were adopted many years ago.

There is one other significant difference between the intra-member rates of the two exchanges. On this Exchange the specialist earns a commission substantially less than the floor brokerage rate on orders entrusted to him for execution though the specialist performs the same service and assumes the same risks as the floor broker. On the New York Stock Exchange, as well as most other exchanges, the specialist receives full floor brokerage on orders left with him for execution. (See Attachment B).

The lower specialist's commission on this Exchange was apparently established for two reasons. First, the specialist on this Exchange also acts as odd-lot dealer and the revenue from this source was supposed to offset the lower specialist's commission. Second, the lower rate was intended to encourage a flow of limit orders to the book, thereby making it easier for the specialist to provide orderly markets.

The Haskins & Sells report examined specialist income. It was their finding that specialist income from odd-lots plus income earned from the present specialist floor brokerage rate was less than the income a specialist would earn if he received the entire floor brokerage as on the New York Stock Exchange.

It should also be pointed out that there are differences in risks when comparing odd-lot dealer activities on this Exchange with those on the New York Stock Exchange. On that exchange, associate brokers of the odd-lot firms can immediately offset positions in the round-lot market. A specialist on the American Stock Exchange cannot offset positions in the round-lot market unless such trading meets the same performance standards now applied to his round-lot training.

Changes in the Exchange Marketplace

In recent years, there have been several important changes in the Exchange marketplace affecting the intra-member commission rate schedules:

1. The average price of shares traded on the Exchange has risen from $7 in 1962 to approximately $24 at the present time, an increase of over 200%. Nearly 87% of Exchange shares volume is now concentrated in stocks selling over $5 per share and 40% of such volume is in stocks selling over $20 per share. Comparable percentages five years ago were 60% and 12%. With the change in the average price of shares traded on the Exchange, income from floor brokerage business has increased substantially. The strengthening of the Exchange's listing and delisting requirements should serve to maintain average share prices at higher levels than in the past and continue the trend away from volume in lower price brackets.

2. Volume on the Exchange has continued to expand, rising from a daily average volume of 1,224,640 shares in 1962 to 4,562,112 shares in 1967.* In the first quarter of

1968 daily average volume rose to over 5 million shares.

3. The steady growth in volume has prompted many commission firms to purchase additional seats on the Exchange or activate seats held by office partners in order to execute transactions through their own floor members.

4. Increased business generated by the successful completion of the new seat plan, in which 151 associate member firms acquired regular memberships, has strengthened the economic position of floor brokers executing business for other members. Despite the presence on the floor of more floor partners representing their own firms, expanding volume has required increasing use of independent brokers to handle overflor floor business.

5. Through intensive efforts over the past several years, the Exchange's specialist system has been substantially strengthened. Specialist units have buttressed their capital and manpower, training programs have helped insure that new specialists are qualified, and specialists have steadily raised their level of performance. As a result of increased demands by the Exchange, specialists have increased their participation, or principal trading, in the market from 10.3% in 1962, when volume averaged 1.2 million shares a day, to 15.5% in 1967, when volume averaged over 4.5 million shares. At the same time, specialist stabilization has risen from 74.6% in 1962 to 95.6% today. Improvement in specialist performance has substantially improved the quality of the market provided by the Exchange.

6. Changes in Exchange volume, price levels and regulatory standards have imposed greater market-making demands upon Exchange specialists. With greater public interest in our market, the Exchange specialist must meet sudden surges in selling pressure or buying power usually concentrated on one side of the market. To fulfill his

function of providing a fair and orderly market, the specialist must risk substantially more capital to take or supply stock in these situations.

Specialists' Commissions

Against this background, the Board of Governors of the Exchange has approved in principle an increase in specialist's commissions.

These considerations were persuasive in adopting that position:

- To attract capital and manpower to specializing there must be a reliable source of income to buffer the risks of dealer activity. Specialists' commission income serves this purpose by providing a continuous source of capital and incentive in the performance of market-making activities during good markets and bad.
- The specialist performs the basic brokerage function with respect to orders left with him for execution. In addition to the actual execution, the specialist has the various tasks and liabilities associated with handling the order and reporting its execution. On most other exchanges the specialist receives the full floor brokerage for performing this service.
- A specialist's ability to make trading profits is restricted by standards of performance imposed by the Exchange upon his market-making activities. These standards have tended to make brokerage commissions an increasingly important source of capital and incentive in the performance of market-making activities.
- Haskins & Sells found that specialist income from odd-lots plus income from specialist commissions is not equivalent to the income a specialist would earn if he received the entire floor brokerage rate as on most other major exchanges.

- Coupled with increased regulatory requirements, the increases in Exchange volume and price levels described above have imposed greater market-making demands upon specialists and obligated specialists to risk substantially more capital.

Finally, the Haskins & Sells report recommended that in view of increased demands made upon the specialist's dealer function, specialist commission income be increased approximately 50%.

Floor Brokerage

After a preliminary review of the intra-member floor rates the Subcommittee has not yet reached any definitive conclusions with respect to floor brokerage rates. However, it is helpful to list some of the reasons it has considered for and against a downward revision in the floor brokerage rate.

Reasons for a downward revision in the floor brokerage rate include the following:

- The rate would be more in line with floor brokerage on other exchanges.
- Such a step would benefit members who are directly responsible for bringing business to the Exchange and who have been faced with steadily increasing costs of doing business.
- A downward revision might encourage firms doing a public commission business to bring more business to the Exchange and make increasing use of independent floor brokers.

Some of the reasons for maintaining the present rate may be summarized as follows:

- The impact of a change on one segment of the membership might be unduly severe.
- If floor brokerage rates are lowered, this would mean that the Exchange, with its direct mail clearance, could compete unfairly with clearing

members having correspondent relationships with out-of-town firms.
- A downward revision in the rates might have an impact on seat values.

Weighing these pros and cons, the Subcommittee is inclined to believe that some lowering of the floor brokerage rate may be necessary and desirable in the best interest of the Exchange and the membership as a whole.

In line with these views and the Board's approval in principle of an increase in specialists' commissions, a test schedule has been prepared which couples an increase in the specialist rate with a downward revision in the floor brokerage rates. This test schedule is set forth in Attachment C for membership consideration.

Future Programs

The Exchange is now planning or implementing several programs which may affect intra-member rates.

In February, the Board of Governors authorized the Exchange administration to develop a plan for the automated execution of odd-lots on the Exchange. The Exchange has a responsibility to insure that it provides efficient service to the membership in the servicing of odd-lot orders. New procedures must be devised to increase efficiency and productivity in the execution of odd-lots and automating odd-lot executions will be a major step in that direction.

The Exchange's automation objectives on the floor are to increase productivity by automating activities which support the auction market, thus permitting greater volume to be handled without proportionate increases in personnel and trading facilities and freeing members from non-productive clerical tasks.

The Exchange has instituted a direct mail clearing service which is now in operation with three firms on line and a considerable number to be added this year. Over 50

firms have indicated their interest in this service. Its purpose is to reduce the cost of doing business on the Exchange for firms which do not have clearing facilities in New York.

The Subcommittee intends to continue its inquiry into all phases of the commission schedule. At this point, however, the comments of regular members, allied members and associate members on the above matters and any alternative approaches will be most welcome. The Subcommittee would appreciate any written comments before May 15, 1968. These should be addressed to Mr. H. Vernon Lee, Jr., Vice President, Membership Services Division. Arrangements can also be made with Mr. Lee's office for a personal appearance before members of the Subcommittee. The Subcommittee and the Exchange administration stand ready to answer any questions you may have.

Sincerely yours,

JOHN H. SCHWEIGER,
Chairman
GORDON H. HENSLEY
JAMES J. LEE
HAROLD J. MINTZ
JOHN WASSERMAN

MACRAE SYKES
FRANK C. GRAHAM, JR.
RALPH S. SAUL
Ex-Officio

ATTACHMENT A

Present Regular Member Schedule

(Rate Per 100 Shares)

Price Range	*Floor Brokerage ASE [NYSE]*	*Clearance ASE [NYSE]*
1/256 of $1	.03 (.05)	.05 (.05)
1/128 of $1	.05 (.10)	.08 (.10)
1/64 of $1 under 2/32 of $1	.17 (.10)	.25 (.20)
2/32 of $1	.17 (.25)	.25 (.375)
over 2/32 of $1 under 8/32 of $1	.33 (.25)	.50 (.50)
8/32 of $1 under 1/2 of $1	.55 (.50)	.85 (.75)
1/2 of $1 under $1	1.00 (.50)	1.50 (.80)
$1 under $2	1.75 (1.25)	2.75 (2.00)
$2 under $5	2.05 (1.40)	3.20 (2.25)
$5 under $10	3.30 (2.10)	4.90 (3.50)
$10 under $20	4.00 (3.10)	6.05 (6.20)
$20 under $40	5.10 (3.65)	7.75 (7.30)
$40 under $100	5.65 (3.85)	8.60 (7.70)
$100 under $150	6.50 (4.35)	9.75 (8.70)
$150 under $200	6.50 (4.50)	9.75 (9.00)
$200 and above	6.50 (5.00)	9.75 (10.00)

ATTACHMENT B

**Present Regular Member
Specialist Floor
Brokerage Schedule
(Rate Per 100 Shares)**

Price Range	*ASE Specialist Fir. Brokerage*	*NYSE Specialist Fir. Brokerage*
1/256 of $1	.01	.05
1/128 of $1	.02	.10
1/64 of $1 under 2/32 of $1	.07	.10
2/32 of $1	.07	.25
over 2/32 of $1 under 8/32 of $1	.13	.25
8/32 of $1 under 1/2 of $1	.22	.50
1/2 of $1 under $1	.35	.50
$1 under $2	.70	1.25
$2 under $5	.80	1.40
$5 under $10	1.35	2.10
$10 under $20	1.70 3.10	
$20 under $40	2.00	3.65
$40 under $100	2.20	3.85
$100 under $150	2.60	4.35
$150 under $200	2.60	4.50
$200 and above	2.60	5.00

ATTACHMENT C

**Regular Member Test Schedule
(Rate Per 100 Shares)**

Price Range				
1/256 of $1	.03 (.05)	.05	.01 (.05)	.03
1/128 of $1	.05 (.10)	.10	.02 (.10)	.05
1/64 of $1 under 2/32 of $1	.17 (.10)	.15	.07 (.10)	.10
2/32 of $1	.17 (.25)	.25	.07 (.25)	.15
over 2/32 of $1 under 8/32 of $1	.33 (.25)	.35	.13 (.25)	.20
8/32 of $1 under 1/2 of $1	.55 (.50)	.50	.22 (.50)	.35
1/2 of $1 under $1	1.00 (.50)	1.00	.35 (.50)	.50
$1 under $2	1.75 (1.25)	1.50	.70 (1.25)	1.00
$2 under $5	2.05 (1.40)	1.75	.80 (1.40)	1.10
$5 under $10	3.30 (2.10)	2.50	1.35 (2.10)	1.70
$10 under $20	4.00 (3.10)	3.50	1.70 (3.10)	2.35
$20 under $40	5.10 (3.65)	4.25	2.00 (3.65)	2.80
$40 under $100	5.65 (3.85)	4.60	2.20 (3.85)	3.00
$100 under $150	6.50 (4.35)	5.20	2.60 (4.35)	3.30
$150 under $200	6.50 (4.50)	5.50	2.60 (4.50)	3.50
$200 and above	6.50 (5.00)	6.00	2.60 (5.00)	3.95

EXHIBIT "D"
LETTER FROM RALPH S. SAUL DTD. 4/24/68

April 24, 1968

The Honorable Manuel F. Cohen
Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Cohen:

We are writing to inform you of steps the Exchange has been taking concerning its commission rate structure. As we mentioned in our letter of August 17, 1967, this matter involves nearly every important aspect of the exchange market and therefore decisions should be made upon the basis of careful study and analysis. We have taken a number of steps in that direction.

Since our letter of August 17, 1967, the Board of Governors of the Exchange has appointed a Subcommittee on Commission Structure to study all aspects of the Exchange's commission rates. As a first step in its study of the entire commission rate schedule, the Subcommittee reviewed the intra-member commission rates of the Exchange. The attached memorandum, which is being circulated to the membership, summarizes the Subcommittee's preliminary views regarding the intra-member commission rate structure and solicits comments and suggestions.

It should be noted that the memorandum does not cover commission rates charged to public customers. This aspect of the commission rate structure is now under study by the Subcommittee.

The Exchange has reviewed Exchange Act Release No. 8239 concerning proposed Rule 10b-10. We feel strongly

that adoption of proposed Rule 10b-10 would not be in the public interest. It would undermine the commission rate structure of the Exchange—a structure which involves the efficiency of our central auction market and the ability of the Exchange to exercise its regulatory responsibilities. In view of these overriding considerations, and others presented in the many comments on the proposal, we urge the Commission to abandon a proposal which could irreparably damage the securities markets of this country.

The Subcommittee on Commission Structure, as part of its review of public commission rates, will consider possible alternative methods for dealing with the problems described in the Commission's Release.

We would like to reiterate our willingness to cooperate with the Commission and other self-regulatory organizations in the resolution of the difficult and complex questions involved in the commission rate area.

Sincerely,

s/ Ralph S. Saul

Enclosure

LETTER FROM MANUEL F. COHEN DATED MAY 28, 1968

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Office of the Chairman

May 28, 1968

Mr. Ralph S. Saul, President
American Stock Exchange
86 Trinity Place
New York, N.Y. 10006

Dear Mr. Saul:

Enclosed is a copy of a letter sent today to Mr. Robert W. Haack, President of the New York Stock Exchange.

The Commission has not directed a similar letter to your Exchange because of possible differences in the situation prevailing. However, the Commission requests that you give immediate attention to appropriate modifications of your commission rate structure, including any necessary interim steps.

Sincerely,

s/Manuel F. Cohen
Chairman

Enclosure

LETTER FROM MANUEL F. COHEN

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Office of the Chairman

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, N.Y. 10005

Dear Mr. Haack:

As you are aware, the commission rate structure of national securities exchanges has been the subject of extensive and continuing study by the Commission. It has become apparent in the course of that study that the present minimum rate structure has led to the development of practices designed to avoid the purported restrictions against the negotiation and the reduction of commission rates. We believe it is now generally recognized that changes in the present commission rate structure are required to benefit the investing public.

The Commission will hold public hearings under Section 21(a) of the Securities Exchange Act of 1934 commencing July 1, 1968, on the question of the commission rate structure of national securities exchanges. A copy of the order for public hearings is enclosed. One subject of those hearings will be whether, in view of present practices, a minimum exchange commission rate structure is necessary, and if so to what extent, in order to achieve the objectives of the Securities Exchange Act of 1934.

The Commission hereby makes written request pursuant to Section 19(b) of the Securities Exchange Act that your Exchange effect on its own behalf changes, to become

effective on or before September 15, 1968, in its rules, policies and practices in respect of its commission rate by modifying Article XV, Section 2(a)(1) and appropriate other sections of the exchange constitution and rules either (a) in accordance with the revised minimum commission rates as set forth in Attachment A, or alternatively, (b) by eliminating, with respect to orders in excess of $50,000, requirements for minimum rates of commission. You should also implement appropriate reductions in the current intra-member rate for non-executing firms or eliminate requirements for minimum intra-member charges to such non-executing firms.

We wish to emphasize that this request is intended as an interim step and that the Commission has reached no definitive conclusion on whether the particular rates described in Exhibit A would reflect the optimum form of rate structure for your exchange or that any schedule of specified rates would provide a complete answer to the problems raised in Release No. 8239 and the comments thereon. Additional measures with respect to other matters, including give-ups are under continuing consideration and will be examined in the course of the hearing commencing July 1, 1968.

The request that your exchange take the foregoing steps is made in the context of the Commission's responsibilities to consider the national policies embodied both in the securities laws and in the antitrust laws. It is based upon the deficiencies in the present exchange rate structure which fails to provide appropriate discounts but permits give-ups direct by institutional managers, with consequent departures from the purported minimum rate structure on an arbitrary and discriminatory basis.

Sincerely,

s/ Manuel F. Cohen
Chairman

Enclosures

ATTACHMENT A

Commissions to Non-Members on Stocks, Rights and Warrants

On stocks selling at $1.00 per share and above the commission on each order shall be not less than the rates hereinafter specified:

(i) On each unit of trading up to and including four units of trading the commission shall be:
2% of first $400 of money involved plus
1% on next $2,000 of money involved plus
1/2% on money involved above $2,400 plus $2.00

(ii) On all units of trading above four units the commission shall be 1/2% of money involved plus $2.00 per unit of trading.

(iii) On odd lots (less than a unit of trading) same rates as that under (i) above, less $1.00.

(iv) Notwithstanding the foregoing:

a) when the amount involved in a transaction is less than $100, the commission shall be as mutually agreed;

b) the minimum commission charge ni any event shall not be less than $6 per order.

In respect of stocks selling at $1.00 and above, an order shall be deemed to include all round lot or odd lot purchases or sales for one account, of a single security, executed on one business day, provided, however, that where an order for five or more units of trading is executed on one business day, all round lot purchases or sales of that security for that account executed in the next nine business days shall be deemed part of that order.

LETTER FROM RALPH S. SAUL DTD. 6/26/68

The Honorable Manuel F. Cohen
Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Cohen:

This letter is in response to your May 28, 1968 letter in which you ask that the American Stock Exchange give immediate attention to appropriate modifications of its commission rate structure, including any necessary interim steps. You also directed the Exchange's attention to an enclosed copy of your letter to Mr. Robert W. Haack, President of the New York Stock Exchange. In the Commission's letter to Mr. Haack, it was stated that the present minimum rate structure has led to the development of practices designed to avoid the purported restrictions against the negotiation and the reduction of commission rates. In addition, the letter requested the New York Stock Exchange to make specified changes in its commission rates. Moreover, the letter stated that the Commission will hold public hearings on the commission rate structure of national securities exchanges.

Your letter and the proposals contained in your letter to Mr. Haack have been presented to the Board of Governors of the Exchange. You noted in your letter to Mr. Haack that the minimum commission rate structure does not provide appropriate discounts but permits give-ups directed by institutional managers.

The Exchange recognizes that as a result of the exceptionally rapid growth of institutional investors during the past decade and the very substantial influence which such investors exert on the members of the Exchange community with whom they deal, certain practices have

developed which place a severe strain on the commission rate structure as conceived and embodied in the Exchange Constitution. Of particular concern is the type of customer-directed give-up which you describe in your letter to Mr. Haack.

The Exchange has also been carefully reviewing its commission rate structure for some time. In addition, the Exchange has analyzed the Commission's proposed Rule 10b-10 and the responses to this proposal. This extensive review along with recent investigations conducted by the Exchange staff and current information developed concerning give-up practices have prompted the Board of Governors to conclude that such customer-directed give-ups may erode the minimum commission rate structure and are not consistent with such structure. Accordingly, the Board has agreed in principle to eliminate such customer-directed give-ups as are noted above.

The Board of Governors of this Exchange has also agreed in principle that a modification of the present minimum commission rate structure to provide volume discounts is appropriate based on all available information and recognizing the uniqueness of this marketplace.

The Exchange's staff has been directed by its Board to work with the Commission to achieve meaningful and prompt implementation of the Board of Governors' position with respect to discounts and give-ups. The Exchange also plans to submit its legal and economic evidence supporting the setting of minimum commissions which, over the years, has made possible a viable, efficient and regulated auction market.

Sincerely,

s/ Ralph S. Saul

RSS:rd

AMERICAN STOCK EXCHANGE

SUBCOMMITTEE ON COMMISSION STRUCTURE

Memorandum

September 20, 1968

TO: Members and Member Organizations
From: Subcommittee on Commission Structure
Subject: Interim Commission Schedule

Last April the Subcommittee on Commission Structure, appointed by the Board of Governors to study all aspects of the Exchange's commission rates, sent the membership a memorandum reporting on work already accomplished and suggesting a revised schedule of intra-member rates. The memorandum did not cover commission rates charged public customers. It requested comments and offered an opportunity for appearances before the Subcommittee. A number of comments were received and several members appeared.

On May 28, 1968, the Securities and Exchange Commission notified the exchanges that it would hold public hearings commencing July 1 with respect to commission rates. The Commission directed the New York Stock Exchange either to adopt a rate schedule proposed by the Commission or eliminate minimum commission rates on orders in excess of $50,000, and to reduce floor brokerage rates. It emphasized that the present rate structure did not provide appropriate discounts while permitting give-ups directed by institutional managers.

At the same time, the Commission requested that the American Stock Exchange give immediate attention to modifications of its rate structure, including any necessary interim measures.

In view of these developments, the Subcommittee

determined to defer any decision with regard to intramember rates.

On June 28, the President of the Exchange notified the membership that after considering information developed regarding give-up practices, the Board agreed in principle to modify the commission rate structure to provide for a volume discount and to eliminate customer-directed give-ups.

On August 8, the New York Stock Exchange proposed its own interim schedule of non-member rates providing for volume discounts, an interim schedule of reduced intramember commission rates and a constitutional amendment prohibiting customer-directed give-ups. Subsequently the Commission ordered the New York Stock Exchange to adopt the Exchange's proposed interim rates or eliminate minimum commissions on orders in excess of $50,000. The New York Stock Exchange is now in the process of submitting its proposed rate schedule to a vote of its membership.

The Subcommittee has considered alternatives to meet the present situation and the recent commitment of the Board with respect to volume discounts and customer-directed give-ups. It reached a number of conclusions which have been reviewed by the Board of Governors and which may be summarized as follows:

Non-Member Commission Rates

The Subcommittee considered the proposed New York Stock Exchange non-member commission schedule and believes it is appropriate for adoption by the American Stock Exchange. It also noted that adoption of a similar schedule would avoid the difficult automation, computer capacity and operational problems which different schedules would pose for dual members.

The Subcommittee also concluded that if the revised interim rates are approved by the membership they should

be made effective on December 5, 1968, the same date the New York Stock Exchange rates are to become effective. This, it was felt, would be helpful to the member firms in effecting the transition to new rates.

The proposed non-member commission schedule is shown in Exhibit I.

Intra-Member Commission Rates

Floor Brokerage

After reviewing various approaches to determining appropriate changes in floor brokerage rates, the Subcommittee concluded that a schedule of rates approximately the same as the test schedule of rates suggested in the Subcommittee's April Memorandum would be appropriate. This schedule, shown in Exhibit II, meets the desire of the SEC for a reduction in floor brokerage rates and is in line with the Subcommittee's conclusion last April that some lowering of the floor brokerage rate was necessary and desirable in the best interests of the Exchange and the membership as a whole. A reduction in these rates would bring them more in line with floor brokerage on other exchanges and would benefit members directly responsible for bringing business to the Exchange. A reduction based on volume was considered but rejected because it presented operational problems.

Clearance Rates

With respect to clearance rates to regular members, the Subcommittee concluded that these rates could most appropriately be set by adding to the newly proposed floor brokerage rates the "clearing portion" of the present regular member clearance rates; that is, the portion of the present clearance rates left after subtracting the present floor brokerage rates. The proposed clearance rate schedule is shown in Exhibit III.

Specialist Rates

The Subcommittee concluded that a schedule of specialist rates providing for an adjustment in line with the Subcommittee"s view in April is appropriate. It reaffirmed that an increase in specialist rates is essential in order to strengthen the specialist system and provide increasingly effective markets on the Exchange. The schedule is consistent with the Board's position late last year. The Subcommittee believes that this step is a necessary one in the progress of the Exchange. On the New York Stock Exchange, as well as most other exchanges, the specialist receives full floor brokerage on orders left with him for execution. The specialist on the American Stock Exchange earns a commission substantially less than the floor brokerage rate or orders entrusted to him for execution, through he performs substantially the same services and assumes the same risks as the floor broker.

The proposed schedule of specialist rates is shown in Exhibit IV.

Associate Member Rates

The Subcommittee concluded that the associate member floor brokerage and clearance rates should not be changed at this time. It is estimated that the cost to associate members for floor brokerage and clearing will continue to be approximately 40% of gross commission income.

Customer-Directed Give-Ups

After studying information available to it, the Board concluded in June that certain customer-directed give-up practices serve to erode the minimum commission structure and are not consistent with the principle of a minimum commission structure. This led the Board to agree in principle to eliminate some undesirable give-ups.

With these factors in mind, the Subcommittee concluded that the Exchange should amend its Constitution by adding to Article VI, Section 1, the language shown in Exhibit V.

The amendment would provide that members and member organizations may not, in consideration of the receipt of business in Exchange securities and at the direct or indirect request of a non-member, give up any work, commissions or other property to which the member or member organization is entitled.

A similar amendment has been proposed by the New York Stock Exchange.

The comments of regular members, allied members and associate members on the above matters will be most welcome. The Subcommittee would appreciate any written comments by October 11, 1968. These should be addressed to Mr. H. Vernon Lee, Jr., Vice President, Membership Services Division.

Arrangements can also be made with Mr. Lee's office for a personal appearance before members of the Subcommittee. The Subcommittee and the Exchange administration stand ready to answer any questions you may have.

Sincerely yours,

John H. Schweiger, Chairman
Gordon H. Hensley
James J. Lee
Harold J. Mintz
James T. Tobin, Jr.
Robert C. Van Tuyl
John Wasserman

Macrae Sykes
Frank C. Graham, Jr.
Ralph S. Saul
Ex-Officio

Attachments

EXHIBIT I

American Stock Exchange

Proposed Non-Member Commission Rates

Sec. 2. Commission shall be as follows:

(a) The Minimum Commission Rates to Non-Members, on Stocks, Rights and Warrants (hereinafter referred to as Stocks) shall be as follows:

(1) On that portion of an order up to and including 1,000 shares, on stocks selling at $1.00 per share and above commissions shall be based upon the amount of money involved in a single transaction and shall be not less than the rates hereinafter specified:

(i) Subject to the provisions of paragraphs 2(a)(1)(iii), 2(f), 2(h), and 2(l), on each single transaction not exceeding 100 shares, in a unit of trading; a combination of units of trading; or a combination of a unit or units of trading plus an odd lot.

Schedule of Stock Commissions

COMMISSION

2% on first $400 of money involved plus
1% on next $2,000 of money involved plus
1/2% on next $2,600 of money involved plus
1/10% on money involved above $5,000 plus $3

(ii(On odd lots (less than a unit of trading) same as paragraph (1) above, less $2.00, subject to the provisions of paragraphs 2(a) (1)(iii), 2(f), 2(h) and 2(l).

(iii) Notwithstanding the foregoing:

(a) when the amount involved in a transaction is

less than $100, the minimum commission shall be as mutually agreed;

(b) when the amount involved in a transaction is $100 or more, the minimum commission charge shall not exceed $1.50 per share of $75 per single transaction, but in any event shall not be less than $6 per single transaction.

(2) On that portion of an order which exceeds 1,000 shares, on stocks selling at $1.00 per share and above, commissions shall be based upon the amount of money involved in a single transaction and shall be not less than the rates hereinafter specified:

(i) Subject to the provisions of paragraphs 2(a)(2)(iii), 2(f), 2(h) and 2(l), on each single transaction not exceeding 100 shares, in a unit of trading; a combination of units of trading; or a combination of a unit or units of trading plus an odd lot.

Money Involved	Commission
$100 to and including $2,800	1/2% of money involved plus $4.00
Above $2,800 to and including $3,000	compute as $2,800
Above $3,000 to and including $9,000	1/2% of money involved plus $3.00
Above $9,000	1/10% of money involved plus $39.00

(ii) The commission on an odd lot of a security in which the unit of trading is 100 shares shall be computed in accordance with the provisions of paragraph 2(a)(1).

(iii) Notwithstanding the foregoing:

(a) When the amount involved in a transaction is less than $100, the minimum commission shall be as mutually agreed;

(b) When the amount involved in a transaction is $100 or more, the minimum commission charged shall not exceed $1.50 per share or $75 per single transaction, but in any event shall not be less than $6 per single transaction.

(3) On stocks selling below $1.00 per share commissions shall be on a per share basis and shall not be less than the following:

Price per Share	*Rate per Share Cents*
1/256 of $1	0.1
1/128 of $1	0.15
1/64 of $1 and above but under 2/32 of $1	0.5
2/32 of $1	0.5
over 2/32 of $1 but under 8/32 of $1	1.0
8/32 of $1 and above but under 1/2 of $1	2.0
1/2 of $1 but under 5/8 of $1	3.0
5/8 of $1 but under 3/4 of $1	3.75
3/4 of $1 but under 7/8 of $1	4.5
7/8 of $1 but under $1	5.25

Notwithstanding the foregoing, when the amount involved in a transaction is less than $100, the commission shall be as mutually agreed; when the amount involved is $100 or more, the minimum commission shall be not less than $6 or the rate per share, whichever is greater.

Definition of single transaction

For the purpose of this Section 2.

(1) In respect of stocks selling at $1.00 per share and above, a single transaction shall be deemed to include all purchases or sales for one account, of a single security, pursuant to a single order.

(i) amounting to 100 shares of a security in which the unit of trading is 100 shares.

(ii) amounting to less than the unit of trading

(iii) amounting to 100 shares or less in one transaction or a series of transactions, pursuant to a single order entered at a single price or at the market, of a security in which the unit of trading is less than 100 shares. If such series of transactions includes an execution in an amount of less than the unit of trading and the order was at a price not more than the usual odd lot differential away from the limit on the full lot order, such odd lot transaction may be deemed to be a part of the single transaction;

(2) in respect of stocks selling at $1.00 per share and above, an order shall be deemed to include all purchases or sales for one account, of a single security, on the same day, pursuant to a single order. Any odd lot of a security in which the unit of trading is 100 shares shall be deemed to be a separate order.

(3) In respect of stocks selling at less than $1.00 per share a single transaction shall be deemed to include all purchases or sales for one account, of a single security, pursuant to a single order, irrespective of the size of the order.

Determining amount involved in transaction

(g) In determining the amount involved in a transaction, commissions and taxes shall be disregarded.

Special Rates

(h) When the commission on any order computed in accordance with the provisions of paragraphs 2(a) (1) and 2(a) (2) would be in excess of $100,000, the minimum commission to be charged shall be $100,000.

(i) Notwithstanding the other provisions of this Article, when Rights or Warrants are admitted to dealings upon the Exchange whether on an issued or when issued basis, and when other securities are admitted to such dealings on a when issued basis the Board of Governors may determine

special minimum rates of commission on any and all transactions in such rights, warrants or other securities. Such special rates so prescribed or provided by the Board of Governors sall be deemed to be the rates prescribed in this Article. Unless special rates have been so determined the minimum rates of commission prescribed in this Article shall apply.

(j) The minimum clearing charges to members, member firms and member corporations applicable to stock, warrant, and right transactions effected by them for their own account shall be as follows:

Round lots: $1.00 a share and over—$3.00 for combined receipt and delivery
Under $1.00 a share—as mutually agreed
Odd lots: Ten shares and over—$1.00 on each side
Under ten shares—as mutually agreed
Warrants: Same as stocks
Rights: As mutually agreed.

Supervised order

(k) When an order is supervised by a regular member, not a partner in or a director of the particular member firm or member corporation whose business he is supervising, the specialist to whom the order is given, either by the member supervising such order or by the telephone clerk of the specific firm or corporation whose name is on the order, shall bill such member supervising the order the specialists' Floor rate and such member shall, in turn, bill the firm or corporation whose name is on the order slip the regular member give-up rate.

Public obligations and called securities

(l) Commission rates to members or non-members may be charged, as mutually agreed, on obligations of the United States, Puerto Rico, Philippine Islands and States, Territories and Municipalities therein, and on securities which, pursuant to call, are to be redeemed within twelve

months, unless commission rates on any or all such securities are prescribed in this Section or by the Board of Governors.

American Stock Exchange

Present and Proposed Floor Brokerage (Give-up) Rates to Regular Members

EXHIBIT II

American Stock Exchange

Present and Proposed Floor Brokerage (Give-up) Rates to Regular Members

Security Price Range [$]	*Present Floor Brokerage* [$]	*Proposed Floor Brokerage* [$]
$1 under $2	1.75	1.45
$2 under $5	2.05	1.60
$5 under $10	3.30	2.45
$10 under $20	4.00	3.60
$20 under $40	5.10	4.25
$40 under $100	5.65	4.50
$100 under $150	6.50	5.05
$150 under $200	6.50	5.25
$200 and over	6.50	5.80

EXHIBIT III

American Stock Exchange

Present and Proposed Regular Member Clearance Rates

Security Price Range [$]	*Present Clearance [$]*	*Proposed Clearance [$]*
$1 under $2	2.75	2.45
$2 under $5	3.20	2.75
$5 under $10	4.90	4.05
$10 under $20	6.05	5.65
$20 under $40	7.75	6.90
$40 under $100	8.60	7.45
$100 under $150	9.75	8.30
$150 under $200	9.75	8.50
$200 and over	9.75	9.05

EXHIBIT IV

American Stock Exchange

Present and Proposed Specialist Rates

Security Price Range [$]	*Present Specialist Rates [$]*	*Proposed Specialist Rates [$]*
$1 under $2	.70	.90
$2 under $5	.80	1.05
$5 under $10	1.35	1.55
$10 under $20	1.70	2.30
$20 under $40	2.00	2.70
$40 under $100	2.20	2.90
$100 under $150	2.60	3.25
$150 under $200	2.60	3.35
$200 and over	2.60	3.70

EXHIBIT V

American Stock Exchange

Constitutional Amendment

The following additional language is to be added to the first paragraph of Article VI, Section 1, of the Constitution:

"No member, member firm or member corporation shall, in consideration of the receipt of business in securities dealt in on the Exchange and at the direct or indirect request of a nonmember or by direct or indirect arrangement with a nonmember, make any payment or give up any work or give up all or any part of any commission or other property to which such member, member firm or member corporation is or will be entitled."

LETTER FROM RALPH S. SAUL DATED MARCH 26, 1970

The Honorable Hamer H. Budge
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Budge:

I am enclosing a statement by the Exchange urging prompt action by the Commission on an interim change in commission rates. We believe that the need for an interim change in present commission rates has been demonstrated.

Our statement also describes a procedure proposed for the future for determining and monitoring subsequent revisions in commission rates to make those rates more responsive to changing conditions in light of the objectives of the Exchange Act. We feel that it would be helpful to make an oral presentation of the proposed procedure described in the statement and, accordingly, request an opportunity to be heard on a date convenient for the Commission. We believe that the Exchange's presentation—directed to future changes in the rate-making process—will be of interest and of help to the Commission.

We respectfully request that the enclosed statement be included in the record of the commission rate hearings.

Sincerely,

s/Ralph S. Saul

Enclosure

LETTER FROM RALPH S. SAUL DTD. 3/26/70

Securities and Exchange Commission
50 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Sirs:

The American Stock Exchange wishes to express its views to the Commission concerning the urgent need for an increase in financial revenue for member organizations, and to urge prompt action on the proposal of the New York Stock Exchange to impose a service charge on each transaction.

The Board of Governors of this Exchange has given extensive consideration to this matter and has concluded that in view of the serious need to provide immediate additional income, particularly to firms engaged primarily in the retail commission business, the imposition of such a service charge is the most appropriate means under the circumstances to accomplish the desired objective. The Board is, therefore, prepared to adopt a rule imposing a service charge of $15.00 on each transaction involving 1,000 shares or less, limited, however, to not more than 50% of the existing commission applicable to such transaction.

The Exchange is aware of the submission by the New York Stock Exchange of an extensive study prepared by National Economic Research Associates, Inc. recommending major revisions in the entire structure and level of commission rates. The Exchange appreciates that review and analysis of this study and underlying data by the staff of the Commission is expected to be time-consuming. In addition the Commission has invited comments regarding the study from all interested parties.

The Board of Governors of this Exchange has concluded that it would be extremely dangerous to postpone any

action concerning commission rates until such review and analysis has been completed. It believes there is a pressing and overriding need for immediate adjustments in the level of income derived from commissions on certain types of transactions in order to preserve the depth and liquidity of Exchange markets, to assure continued, direct access to the Exchange marketplace by the general public, to bolster the financial condition of member organizations, and thus to protect the interests of all investors. The proposal to impose a service charge involves only such limited revision to the commission rate structure as the Board believes absolutely essential at this time to help achieve these objectives and to stem certain trends which, if unchecked, may seriously undermine Exchange markets and impair the ability of public investors to freely buy and sell listed securities in a regulated exchange auction market.

We recognize that a great deal of work remains to be done in connection with resolving all of the issues relating to commission rates. The American Exchange, as more fully described below, is devoting a considerable effort to the development of procedures for establishing commission rates in the future. We believe these procedures will prove much more meaningful than those available in the past for determining rates. However, the current need for an adjustment is so urgent that neither the Exchange nor the Commission, in carrying out their statutorily imposed duties, should delay in implementing an interim change.

Need for Direct Public Participation in the Securities Markets.

The evidence presented in the Commission's rate inquiry demonstrates clearly the fundamental changes that are taking place in the public securities markets. The growth in institutional trading is progressing at a much more rapid rate than that of individual public investors. Transactions originating with institutions as a percentage of total public share volume on the New York Stock Exchange have in-

creased from 29.4% in 1959 to 54.4% in 1969. Studies of trading on the American Exchange indicate a similar growth pattern even though institutional trading as yet represents a smaller portion of total volume. During a two-year period—from 1967 to 1969—institution trading on this Exchange as a percentage of total public share volume increased from 15.6% to 22.9%.

The annual growth rate in institutional trading on this Exchange between 1967 and 1969 (as a percentage of total public share volume) was 47.5% whereas trading by individuals grew at an annual rate of only approximately 16.5%. If these growth patterns are sustained by both individuals and institutions in the future, institutional share volume on the Exchange will attain the level experienced on the NYSE in 1969—approximately 54% of public share volume—in about six years. In short, our market, which in the past has principally served individual investors, is likely in less than six years to become weighted on the side of institutional investors if current trends continue unabated—and the NYSE will be primarily an institutional market by that time. Attached as Exhibits A and B are the results of studies for 1967 and 1969 respectively, comparing transactions, shares and dollar volume on this Exchange for individuals and various categories of institutional investors.

The growing influence of institutional participation on the Exchange is illustrated further by the growth of block transactions—trades involving 10,000 shares or more. Block trading as a percentage of total share volume has grown at the rate of 92% per annum between mid-1966 and 1969, a rate 3.7 times faster than the growth of total share volume during this period. The 1969 study indicates that approximately 73% of all block transactions on the Exchange are traded by institutional customers. The growth in block trading has continued despite the decline in overall volume during the past few months. Although detailed

analysis of current data is not yet available, a preliminary review of January 1970 trading indicates that share volume represented by blocks is up 20% over January 1969 although total trading volume has declined more than one-third.

The significance of these trends, must not be underestimated in terms of the impact which institutionalization is having on Exchange markets. The ability of the Exchange to accommodate the growth of institutional trading is to a very large extent dependent upon a corresponding growth in the flow of orders from individual investors. Without the individual investor the market tends to lose the benefits of a public pricing mechanism and is likely to become largely a negotiated market with more and more trades being converted from agency transactions to dealer transactions. It is readily apparent that any significant decline in participation by individual investors will seriously affect the depth and liquidity of the public auction market—a result which nearly every participant in the pending commission rate hearings has conceded would be inimical to the interests of all investors, individuals and institutions alike.

Circumstances Threatening Continued Public Participation.

At the time the Commission initiated its present commission rate inquiry in 1968 the securities industry was reaching the peak of an unprecedented period of growth. The volume of trading in all markets had multiplied at a rate previously unknown and had far outdistanced the most optimistic projections made only a few years earlier. Securities prices had maintained a general upward trend for several years with only sporadic interruptions. All classes of investors were anxious to see their capital fully invested. The emphasis of many portfolio managers changed from conservation of capital to performance measured by gains from rapid turnover of securities

holdings. Brokerage firms were operating at a profitable level and were expanding their facilities to meet the increased volume. Although this growth was not spread evenly over the entire spectrum of public investors, the sheer magnitude of trading volume tended to assuage any fears concerning the liquidity of securities markets.

Events of the past year have evidenced a dramatic reversal in many of these trends. Trading volume has subsided to a marked degree. The general level of securities prices has declined substantially. Many member firms have either reported losses or drastically reduced profit margins. These developments have occurred at a time when there has been increasing pressure on member firms to improve their operating procedures and to make additional investments in facilities and highly skilled personnel so as to meet the needs of their customers. There have been a number of mergers by member organizations in an effort to improve overall capital positions. Some have been forced to liquidate and have required financial assistance to protect the funds and securities of their customers. Many firms have found that they have excess capacity as a result of expansion during earlier years to meet increased volume and to solve lingering back-office problems, but they have also found that high fixed costs in connection with such expansion cannot be promptly reduced or eliminated. The climate in the securities industry in 1970 is substantially different from that in early 1968, and we see major changes taking place in terms of the allocation of capital and resources of member organizations which may permanently reshape the securities markets—changes which as a result of economic pressure are designed primarily to improve the servicing of institutional customers and largely ignore individual investors.

The most immediate impact of these changed conditions has been a decline in the profits of member organizations oriented to serving individual public customers. It is these

firms that have found the greatest difficulty in generating adequate income to meet ever increasing costs. The rising costs of conducting a brokerage business have been well documented and can be measured by any number of indices. Such increased costs must be considered in light of the fact that there has been no increase of any kind in public commission rates for more than a decade. Under these circumstances, a significant consideration is the way in which member organizations have reacted to the cost-profit squeeze.

In an effort to obtain current information concerning member firm reaction to declining profit margins, we have interviewed a number of member organizations during the past couple of months and we feel that the results of these interviews indicate that measures are being taken which may adversely affect public investors. While the majority of the firms involved in our survey were heavily committed to the retail commission business, we endeavored to include a broad cross section of our membership. The firms surveyed accounted for approximately one-third of the trading volume on the Exchange during 1969. Without exception these firms voiced the opinion that the small, individual investor's business is unprofitable at the current commission rate level.

More importantly, the survey disclosed strong indications that many firms are no longer encouraging or seeking to develop the business of the small investor and, in fact, in many instances they have adopted or are developing policies designed to discourage this type of business. For example, several firms which have traditionally concentrated on retail commission business have recently altered their registered representative compensation policies to provide greater rewards for producing large volume orders while reducing the amount of compensation payable in connection with small orders.

It is also apparent that administrative steps are being taken to emphasize and service larger volume orders as opposed to accounts which involve only small trades. Some firms are imposing a minimum initial investment of from $2,000 to $5,000. Branch offices in smaller cities are being closed. The physical location of new offices is sometimes being selected to avoid walk-in business. Added emphasis is being placed on the development of institutional business at all levels in many firms.

An equally important factor is that many firms are seeking or developing other lines of business such as investment advisory services, real estate investments, writing of options, establishing their own mutual funds and trading in commercial paper. Another trend indicated by our interviews is that more firms are now willing to utilize their capital to "block position" as a means of increasing their institutional business. The attached Exhibit C provides a more detailed summary of the views expressed by the member firms we contacted.

There are other factors which at the present time tend to deter member organizations from seeking to develop small investor business. They have been forced to operate in an unstable environment which mitigates against long-range planning or major capital commitments. There is uncertainty as to how the controversy over negotiated rates versus fixed minimum commissions will ultimately be resolved; there is no clear policy commitment by the regulatory agencies aimed at preserving the central exchange markets or assuring continued direct access to such markets by individual investors; there is the spectre of prolonged and exhaustive study and analysis before any increase in revenues can be effected to correct a demonstrated drain on profits.

Direct public participation in the securities markets is also threatened by the attitudes of individual investors who appear to have a growing sense that they cannot receive

service on an equal basis with institutions. Last summer a survey was conducted for the Exchange by Louis Harris and Associates, Inc. concerning the attitudes and opinions of investors towards the securities markets and to gain insight with respect to their intentions and anticipations in relation to investing practices. A significant conclusion of this survey was that even experienced investors believe that institutions are given preferential treatment by the securities industry.

Alternatives Available to Member Organizations.

Even without resorting to an exhaustive analysis of cost data, it is quite apparent that operating costs of brokerage firms over the past twelve years, since the last commission rate increase, have been rising at an alarming rate and that income generated from public commission business has not been sufficient to offset these increased costs. As indicated above, our survey of member organizations confirms that this cost-profit squeeze has had the most severe impact on those firms heavily committed to the retail commission business.

Every firm the Exchange interviewed in this category indicated that it had experienced either a loss or substantially reduced profits during 1969. Moreover, all of these firms are determined to take prompt steps to correct this situation and they are convinced that they cannot unilaterally raise commissions above the prescribed minimum as a means of making the retail commission business profitable. The Exchange believes that the measures taken or contemplated by many of these firms to discourage the small investor's business—steps which the firms feel are an economic necessity—are contrary to the principles underlying the Exchange Act and the objectives sought to be achieved in providing for regulated markets—that is protection of the investing public.

Faced with the probability of continuing losses or only marginal profits in handling retail commission business,

such firms are increasingly turning to other sources of business that appear to be more profitable. This includes concentration on institutional business, engaging to a great extent in dealer transactions, implementing investment advisory services, developing and selling their own mutual funds, writing options, trading in commercial paper, developing real estate investments, etc. Many of these endeavors may require additional capital but they do not necessarily involve the high degree of fixed overhead costs necessary in maintaining facilities, data processing equipment, personnel, branch offices and communications systems for handling of retail commission business.

Risks in Delaying Action on Commission Rate Revisions.

In addition to the possible impact which may result from a reallocation of resources and capital by member firms, consideration must be given to the danger of postponing action on commission increases while many firms are experiencing serious financial difficulties. Corrective measures by the firms themselves may not serve to reverse this trend. As indicated above, several large commission firms have reported severe losses this past year and some have had to supplement their capital on an emergency basis. There have been a number of mergers in the industry resulting from financial difficulties and in severe situations firms have had to be liquidated. The adoption of provisions to provide additional means of raising capital may be largely illusory if the risk factor of investing in brokerage firms is too great.

Exchange member firms hold billions of dollars in securities and funds of countless public investors. Public confidence in the financial stability of these firms is essential to the overall economy. Serious difficulties that befall any one firm not only have a serious impact on its customers but also affect all other financial organizations with which the firm has dealings.

We also believe that there are other serious policy questions which must be considered. Is the public interest served if only the very large, multi-purpose firms can survive fluctuations in trading volume and continue to handle public commission business? Are smaller firms oriented to dealing with the public to be given a fair opportunity to compete? To what extent is investor protection sacrificed if firms are forced to cut back on services and operations in order to stay in business? How can competent personnel be attracted to the industry and be properly trained to carry out their functions in handling investments for the public if the level of anticipated compensation is not competitive with other industries? The current profit squeeze associated with the retail commission business is having its impact on all of these matters.

Problems with Past Approaches to Commission Rate Changes.

Past practices in implementing commission rate changes have been subjected to criticism from various sources. Part of the problem has been the lack of any definition as to the objectives which commission rates should be designed to achieve and the failure to develop appropriate procedures to assure the responsiveness of commission rates to changing conditions.

In this connection, there has been no machinery for continually monitoring commission rates or for determining whether existing rates are achieving desired results. No process has been developed for regularly obtaining the views of all segments of the industry, and proposed changes have seldom been submitted for comment to those likely to be most affected. Little effort has been made to develop and apply economic tools in setting rates or measuring the consequences of changes. The impact of rate changes on different classes of investors has received relatively little attention.

Acknowledgment of past imperfections is not an attempt to either disparage nor excuse. It is simply a recognition that today better tools are available—partly because of advanced technology and party because there is a better understanding of the industry and improved reporting of data.

Steps to Improve the Rate-Making Process.

Since the commencement of the commission rate inquiry, the American Exchange has embarked on a program to determine how the rate-making process can be improved—particularly with respect to measuring the economic impact of commission rate changes and developing procedures to make the rate-making process more responsive to changing market conditions. In July of 1969 we submitted to the Commission an interim report concerning our efforts in this direction. We outlined a number of public interest objectives which we believe are relevant to the fixing of commission rates and pointed out the need for developing tools to assist in predicting the impact of rate changes in relation to such public interest objectives.

In our July 1969 presentation we indicated our disagreement with the position that the question of commission rates can be viewed in isolation or can be answered in simplistic terms. We believe that economic analysis of the consequences and of behavioral patterns likely to result from changes in commission rates must go hand in hand with measuring direct financial impact, and that such consequences and behavioral patterns must be considered in the light of public interest objectives. Before this can be accomplished there must be agreement as to the objectives. Specific policy decisions must be articulated with respect to such matters as the desirability of preserving the central auction markets, assuring continued public access to such markets, maintenance of the public pricing mechanism, achieving fair treatment of both large

and small investors, maintenance of adequate levels of services to investors, developing sufficient capacity, improving self-regulation, providing a fair opportunity for small brokerage firms to compete, etc. Only by appropriate consideration of all of these factors on an integrated basis can the rate-making process be developed into an effective means of protecting the interests of investors, providing a reasonable level of income to member organizations and assuring the public character of the securities markets.

In an effort to obtain independent guidance and advice concerning the approach to be taken to these problems, the Exchange engaged Cambridge Research Institute to assist in developing a long-range program that would help us to both measure impact and predict consequences of commission rate changes. A summary of the results of Cambridge Research Institute's work is attached as Exhibit D.

The Exchange believes that this suggested approach may serve as the groundwork for developing the necessary procedures to measure the economic impact and possible consequences of proposed commission rate changes through the use of advanced computer technology and the application of economic principles. The computer programs prepared by Cambridge Research Institute for this purpose and the steps which they suggest for gathering and analyzing the necessary data are only a start. They, of course, had to rely on available data—data which is now nearly three years old and thus reflects market conditions which have little relationship to the situation today. Moreover, the data which was available was not gathered for the purpose of analyzing the impact of changes in commission rates and consequently was not in a form to provide meaningful results. Moreover, this was an attempt to break new ground and it was expected that the initial effort would require further development based on improved reporting of data and actual experience in applying the suggested procedures.

This project to date has proven to be extremely expensive to the Exchange. It is a pioneering effort and a great deal of work remains to be done. It is possible that completion of all phases of the project as outlined by Cambridge Research Institute may be beyond the capabilities and resources of the American Exchange alone. However, we believe the basic approach is sound and that with up-to-date data and improved reporting requirements, this technology can be brought to the point where it will prove to be a valuable tool in the rate-making process.

Procedures for Periodic Review of Commission Rates.

The Exchange has considered the need for developing a continuing program for establishing and monitoring commission rates which will be responsive to changing conditions and which will be directed to achieving public interest objectives along the lines set forth in our July 1969 presentation. Basic to this rate-making approach is the formation of a facility at the Exchange which will have responsibility for collecting and processing data on a continuing basis so that periodic studies concerning the effects of existing rates or of proposed changes in rates can be carried out on a sound factual basis and can be properly documented.

It is anticipated that periodically an in-depth review will be made of commission rates. This process may include the forwarding of summaries of data collected on a continuing basis to member firms together with comments by the Exchange staff concerning current problems involving commission rates. Member firms would be requested to submit recommendations as to any revisions they believe appropriate and a record would be made of all such recommendations. Proposed changes in the rate schedule could be devised, relying on the submissions received from member firms, the data collected and analyzed over a period of time and the projected consequences resulting from such proposed changes, or in the alternative it might

be determined that no revisions were warranted. If it were found that changes in the commission rate schedule appeared justified, the Exchange could publicly announce its intention to propose certain revisions and its reasons therefor, and invite comment on the new rate schedule from member firms and other interested parties. Thereafter, the Exchange could review the proposed schedule with the Commission in light of the record made and the data on which its decision concerning necessary revisions was reached, prior to submitting the proposal to the membership for approval.

Such procedures would permit focusing on explicit issues in the rate-making area and should provide some measure of negotiation with respect to such issues in a manner consistent with a regulated industry. If these procedures prove both workable and beneficial, it may be possible to establish machinery by which the Board of Governors could make appropriate modifications to existing commission rates within certain defined limits without having to resort to a vote of the membership in every case. This would enable the Exchange to respond more rapidly and flexibly to changing conditions while at the same time reserving for the membership the authority to make major revisions in commission rates.

Sincerely,

s/ Ralph S. Saul

EXHIBIT A

RESULTS FROM THE 1969 TRANSACTIONS REVENUE STUDY

Account Type	*Transactions*		*Shares*			*Dollar Volume*		
	Number	*Percent*	*Number*	*Percent*	*Average Shares*	*Dollars*	*Percent*	*Average Dollars*
Individuals	37,488	90.0	6,513,082	77.1	173.9	129,279,530	69.3	3,452
Commercial Banks or Trusts	936	2.3	493,343	5.8	527.1	16,035,498	8.6	17,152
Non-Member Broker-Dealers	1,063	2.6	264,228	3.1	248.6	6,011,135	3.2	5,652
Mutual Funds	197	0.5	413,160	4.9	2097.3	13,519,234	7.3	68,626
Investment Partnerships	433	1.0	239,803	2.8	553.8	7,019,188	3.8	16,211
Non-Insurance Private Pension Funds	116	0.3	56,333	0.7	485.6	1,827,086	1.0	15,751
Life Insurance Companies	16	0.04	27,410	0.3	1713.1	901,101	0.5	56,319
Non-Life Insurance Companies	66	0.2	30,280	0.4	458.8	673,921	0.4	10,211
Non-Bank Trusts or Estates	205	0.5	49,394	0.6	240.9	1,264,629	0.7	6,169
All Other Institutions	1,109	2.7	362,143	4.3	326.5	9,981,756	5.4	9,001
Total	41,589	100.0	8,449,176	100.0	203.2	186,513,077	100.0	4,485

EXHIBIT B

RESULTS FROM THE 1967 PUBLIC TRANSACTION STUDY

Account Type	*Transactions*		*Shares*			*Dollar Volume*		
	Number	*Percent*	*Number*	*Percent*	*Average Shares*	*Dollars (billions)*	*Percent*	*Average Shares*
Individuals	28,701	90.3	4,805,696	84.4	167.4	88,913,234	76.9	3,098
Commercial Banks	519	1.6	247,676	4.4	477.2	11,200,926	9.7	21,582
Non-Member Broker-Dealers	575	2.4	193,428	3.4	255.5	3,125,261	2.7	4,128
Mutual Funds	145	0.5	88,443	1.6	610.0	4,126,900	3.6	28,461
Non-Financial Corporations	354	1.1	93,657	1.6	264.6	2,188,556	1.9	6,182
Investment Clubs	310	1.0	35,661	0.6	115.0	748,880	0.7	2,416
All Other Institutions	992	3.1	230,705	4.1	232.6	5,342,043	4.6	5,385
Total	31,778	100.0	5,695,266	100.0	179.2	115,645,793	100.0	3,639

EXHIBIT C

SUMMARY OF VIEWS EXPRESSED BY FIRMS SURVEYED

1. All of the firms surveyed believe that small ticket business is unprofitable.

2. All of the firms in the survey which do a public business have decided to discourage small order business or decrease their emphasis on such business.

A. Change registered representative compensation policy so as to provide greater reward, and thus greater incentive, for large ticket business.

B. Require minimum initial investment before accepting an account.

C. Purge all accounts which do not maintain a minimum equity.

D. Purge inactive account.

E. Impose a minimum commission charge per ticket.

F. Close branch offices in smaller cities.

G. Select physical location of branch office so as to avoid walk-in business.

H. Curtail or discontinue advertising in public media.

3. All of the firms surveyed have placed greater emphasis on institutional business in recent months.

A. Have established separate institutional sales departments.

B. Have augmented existing institutional sales departments.

4. The majority of the firms surveyed have increased their emphasis on block trading.

A. Many will commit capital to block positioning.

B. Many have established separate block trading departments.

5. A vast majority of the firms surveyed have entered or decided to enter into new lines of business.

A. Real estate.
B. Investment advisory service.
C. Selling their own mutual fund.
D. Options.
E. Commercial paper.

6. All of the firms surveyed report that operational costs have increased substantially.

A. Major factor is salary demands of clerical, supervisory and professional personnel.

B. Cost of installation, maintenance and operation of automation equipment.

7. All of the surveyed firms report that there exists little if any possibility of reducing these operations costs.

A. Necessity of maintaining excess capacity.

B. Anticipation of even greater increase in operations payroll because of limited labor supply.

	Nature of Business	% of 1969 Total ASE Volume	No. of Branch Offices	No. of Registered Representatives	Loss or Decrease in Profits in 1969	Increased Operational Costs in 1969
Firm K	Retail, Institutional, Corporate Finance	.77%	13	175	NO	YES
Firm L	Institutional Retail	.734%	13	230	NO	YES
Firm M	Less than 50% Commission Business	.575%	19	180	NO	YES
Firm N	Predominantly Correspondent, Small Institutional	.7252%	—	—	NO	YES
Firm O	Correspondent, Corporate Finance, Small Retail	1.48%	6	38	NO	YES

DESCRIPTIVE CHART OF FIRMS SURVEYED*

	Nature Business	% of 1969 Total ASE Volume	No. of Branch Offices	No. of Registered Representatives	Loss or Decrease in Profits in 1969	Increased Operational Costs in 1969
Firm A	Predominantly Retail	2.49%	105	1,500	YES	YES
Firm B	Predominantly Retail	1.77%	96	1,100	YES	YES
Firm C	Predominantly Retail	4.14%	123	1,700	YES	YES
Firm D	Predominantly Retail	1.78%	70	1,250	YES	YES
Firm E	Predominantly Retail	1.11%	68	800	YES	YES
Firm F	Predominantly Retail with Broad Mix	7.87%	159	2,300	YES	YES
Firm G	Predominantly Retail	2.02%	59	680	YES	YES
Firm H	Predominantly Retail	2.74%	95	1,500	YES	YES
Firm I	Predominantly Retail	1.79%	57	1,000	YES	YES
Firm J	Predominantly Retail	2.59%	83	1,300	YES	YES

*Represents 30.98% of volume on American Stock Exchange for 1969.

	Increased Emphasis On Institutional Business	*Experienced Increase in Block Volume*	*Will Block Position*	*New Lines of Business Established or Contemplated*	*Change in RR Compensation Policy Established or Contemplated*	*Minimum Per Ticket Charge Established or Contemplated*
Firm	YES	YES	YES	YES	YES	YES
Firm B	YES	YES	NO	YES	YES	YES
Firm C	YES	YES	YES	YES	YES	YES
Firm D	YES	YES	NO	YES	YES	NO
Firm E	YES	YES	NO	YES	YES	NO
Firm F	YES	YES	YES	YES	YES	NO
Firm G	YES	YES	NO	YES	YES	NO
Firm H	YES	YES	YES	YES	YES	YES
Firm I	YES	YES	NO	YES	YES	YES
Firm J	YES	YES	NO	YES	YES	YES
Firm K	YES	YES	YES	YES	YES	YES
Firm L	YES	YES	YES	YES	YES	YES
Firm M	YES	YES	YES	YES	YES	YES
Firm N	YES	YES	NO	NO	—	—
Firm O	YES	YES	NO	NO	NO	NO

EXHIBIT D

THE AMEX COMMISSION RATE STUDY

This statement describes a methodology that CRI has developed on behalf of the American Stock Exchange. The methodology was designed to help in answering the following kind of question. If a new commission rate structure is introduced on the exchanges, how will the new rate affect the operations of the exchanges and their members; and how will these consequences, in turn, affect the public interest?

I. The Methodology in Brief

Vast changes are going on in the securities business and in the public's use of the securities markets. As these changes occur, they repeatedly raise the question of the desirability of changing the commission rate structure on the nation's securities exchanges. In order to explore the desirability of any proposed change, one wants to be able to estimate some of its consequences in advance. Is there some systematic way of exploring these consequences?

Obviously, serious estimates of this sort require a formal method of estimation. But they also require experience and judgment. The challenge is to find a way of blending technique and judgment to produce reasonable and credible results.

We begin with the fact that a certain pattern of trading already exists on the exchanges. Beginning with the existing pattern, any proposed change in commission rates can be looked at with the following set of questions in mind:

1. If the proposed commission rate were put into effect and if existing patterns of trade were to continue unchanged on the exchanges, what would happen to the commission income of member firms? (Below, we will call

these results the "first-round effects" of a commission rate change.)

2. The chances are, however, that any large changes in commission rates would also generate changes in trading patterns on the exchanges. If the proposed commission rate changes were put in effect, what changes in trading patterns do they seem likely to induce? And given these changes, what would happen to the commission income of the member firms? (We shall be calling these results the "second-round effects".)

3. Finally, these changes in commission rates and in market performance will have all sorts of consequences that bear on the public interest. CRI was well aware that "the public interest" could not be precisely defined, nor did it attempt to sharpen the meaning of the term. However, a number of eminent economists, in hearings before the SEC, had previously identified various criteria reflecting "the public interest". Many of these criteria, listed in Appendix A, were of the sort that could be linked to crude quantitative indexes. A criterion such as "preservation of a central auction market", for instance, could be linked to changes in the number, size, and geographic distribution of member firms. CRI's methodology, therefore, is intended to link the changes in commission rates and in market performance to the changes that might ensue in the "public interest" criteria.

The remainder of this memo explores the methodology associated with each of these three stages: measuring the "first-round" effects; measuring the "second-round" effects; and relating these effects to change in the "public interest" criteria.

II. First-Round Effects

How does one go about measuring the impact of any given change in the commission rate structure on commission income, assuming that the patterns of trading themselves are not affected by the commission rate change?

A. *The Starting Point*

Fortunately, the exchanges already have some experience with collecting the data that provide a platform for such measurement. The basic data consist of a detailed record of the transactions effected on the exchange for any day or any given group of days. For each such transaction, a record is made of:

1. the number of shares bought and sold;
2. the price per share;
3. the type of customer, classified according to whether an individual, bank, mutual fund, etc.
4. if an individual, his age, sex, geographic location, and estimated income;
5. approximate time the stock was held;
6. whether the stock was purchased with cash or on margin.

Inevitably, the collection and storage of data of this sort involve a very considerable effort. One day's transactions on the American Stock Exchange, according to our experience, involves over 32,000 transactions. Following the pattern suggested above, 18 bits of information have to be recorded for each transaction, making a total of nearly 600,000 pieces of information in all. Nevertheless, CRI has devised a series of data storage and data retrieval programs that will permit the ready handling of data of this sort, without limit as to the number of trading days to be analyzed. The CRI system is referred to in the remainder of this memo as the CRI EXCHANGE DATA SYSTEM.

B. *The First-Round Analysis*

Once figures of this sort have been collected and stored, they can begin to answer all sorts of "first-round" questions. To gain an understanding of the versatility of the analysis, picture a table along the following lines:

PROPOSED COMMISSION RATE SCHEDULE X

Commissions Generated by Transactions on AMEX,
Based on Transactions on (date)
(Figures shown in dollars of commissions)

Member Firm Name	Customers by Type: Individual	Bank	Mutual Fund	.....	All Customers
Alpha					
Beta					
Gamma					
—					
—					
—					
Omega	-----	-----	----		-----
All Firms					

The CRI EXCHANGE DATA SYSTEM, now in the possession of AMEX, has the capability of creating tables of this sort, so long as the data are based on the transactions of any day or days that have been stored in its data file. The figures in the table can be computed for any commission rate schedule, actual or hypothetical. Obviously, therefore, the same kind of table can be prepared for the differences in commission revenue between any two schedules.

The table above, however, is no more than illustrative of the capabilities of the CRI EXCHANGE DATA SYSTEM.

The table represents only one possibility for computing commission revenues and commission revenue changes by categories. One could, for instance, alter the categories across the top of the dummy table above so that, instead of breaking down the figures by customer types, the figures are broken down according to size of transaction. A sample table of this sort, would look as follows:

Member Firm Name	Transactions by Size: $1-$500	$501-$1000	$1001-$10,000	....	All Transactions
Alpha					
Beta					
Gamma					
–					
–					
–					
–					
Omega	——	——	——		——
All Firms					

These illustrations could be carried much further. Margin transactions could be distinguished from cash; short-term holdings from long; high priced stocks from low; and so on. Morever, cross-categories can be presented so that an analyst can distinguish the "first-round" effects on, say, the small blocks of individual traders from the effects on the large blocks of such traders.

Although the sample tables just presented list their results by individual firms, the results can be presented just as readily by categories of firms, as long as a basis exists for classifying each firm according to some meaningful category. For instance, firms can be classified according to size; according to the type of service provided to the public;

according to membership affiliations; and so on. Once each firm is so typed, all the figures that are available by individual firms can reasily be provided by each type of firm. The present version of the CRI EXCHANGE DATA SYSTEM has a built-in capacity for such classification, based on data already obtained from AMEX. These data included some 48 separate pieces of information available for some or all of 667 firms. The classification system can be extended as the data describing the firms are extended and refined.

III. *The Second-Round Effects*

A great deal can be learned simply by scanning the results generated as the "first-round" effects of any proposed commission rate change. But the simplifying assumption— "assuming that the change in rates does not affect the pattern of trading"—will unavoidably limit the credence to be accorded the observed results. For this reason, one is obliged to push off from the seemingly solid footing of the "first-round" into the more uncertain territory of the second round.

A. *The Approach*

Early in the study, CRI had recognized that any change in the commission rate structure could have far-reaching consequences on the behavior of member firms and the behavior of customers. If the rate changes were drastic enough, customers and member firms would both change their ways of doing business. The patterns of trade portrayed in the base data would give way to something else. One would have to guess at what that "something else" would be before he could gauge the public interest effect.

One of the past weaknesses of studies of commission rate changes, it was recognized, was a failure to take these possible changes in behavior into account when estimating the effects of proposed alternative commission rate structures. But how to take them into account?

One thing was sure. However desirable it might be in the abstract, it would be hopeless to try to estimate the effect of any alternative commission rate structure upon every possible customer type, broken down by every possible type of member firm for each security price level. In the abstract, the number of such categories for comparison would come to about 3,500 possibilities: 7 customer types *times* 50 member firm types *times* say, 10 security price levels. If six different commission rate schedules were to be compared with the present schedule and with one another, the 3,500 possibilities would rise to 73,500 possibilities, an absurdly high total. Obviously, therefore, one would have to concentrate his analysis on the customer-firm-transaction categories where the first impact of a rate change would be very large.

But, how to determine these categories? To pinpoint the categories, it was necessary to have a capability for first-round analysis that could sort the transactions by many different combinations of firm types, customer types, security price ranges, or other relevant criteria—and to do all this expeditiously and flexibly. The CRI data system has been designed with these needed capabilities in mind. It permits the analyst to scan first-round effects, classified in various meaningful ways. This increases the chances that one can pinpoint the areas where market operations might be substantially affected by a proposed commission rate change.

B. *The follow-up*

Since any proposed change in commission-rate structure has its own distinctive effects, one cannot say in advance just which areas of follow-up would be most necessary. Let us suppose, however, that a structure were proposed whose first-round effects seemed to be concentrated mainly in two areas. One of the assumed first-round effects would be to add greatly to the income of any firm that set itself up to handle small-lot individual business; the second would be

to reduce greatly the commission costs and commission revenue associated with the handling of large-block institutional business. Faced with that impact, the critical question for judgment would be: How could the member firms and public traders be expected to respond to these changes in circumstance?

Any effort to judge the "public interest" effects of any commission rate change unavoidably involves this kind of question. If some other approach seems not to raise the question, it is only because the approach is imprecise enough so that the question is buried, undetected and unrecognized, somewhere in the decision-making process. Moreover, any effort to answer a question of this sort is, just as unavoidably, based to some extent on judgment and experience. Some judgments will be better than others, of course. Some judgments will be built up, for instance, from statistical studies of the effects of exchange rate changes in the past, in hopes that such past reactions can be used as a guide to the future; some will be based on the experience of those in a position to gauge customer reaction; and so on.

The virtue CRI can claim for the approach it has developed here is that the areas where the critical judgments will be needed can be isolated with greater facility and examined with greater clarity than in the past. The wisdom of the judgments themselves are another matter; these depend on how well customer and firm behavior can be estimated.

Let us assume, however, that the judgments are made and the problem is to explore the consequences. Such judgments would be framed in the form of so-called "decision rules". That is to say, they would take the form of statements such as the following: "If the commission rate on transactions under $500 rises by 100 percent, then individual traders will increase (or decrease) their trading in such blocks by 5 (or 10 or 15 or 'x') percent." If those alternatives did not seem to exhaust the plausible

possibilities for the individual traders' behavior with respect to blocks under $500, then other "decision rules" could be tried for their effects. At the same time, one or more decision rules for each other important category would be formulated.

Whatever the decision rule may be, it is used in the DATA SYSTEM for the purpose of generating a new round of trading volume and commission revenue estimates. If there is no *a priori* basis for distinguishing among different decision rules for plausibility—if all of them appear equally plausible or if informed people are in disagreement over their relative plausibility—then all are tried as alternative possibilities. This process of working through different sets of predictions of behavior is available because of the efficiency of the DATA SYSTEM designed for the purpose. If the commission revenue outcomes prove insensitive to the different assumptions, then the problem diminishes in importance or goes away, if the outcomes prove sensitive, then one is confronted with the stark and unavoidable question of choosing the most plausible decision rules. Out of this choice, new estimates are developed, which provide the basis for the next and final phase.

IV. *The Final Phase—Measuring Public Interest Impact*

Note where the analysis has carried us to this stage. (1) The first-round impacts of proposed commission rate changes have been identified; and (2) the best estimate of second-round effects have been made. A new equilibrium emerges. But in public interest terms, would the new equilibrium be better or worse than the old?

"Public interest" is whatever the political process, broadly defined, decides that it should be. CRI assumed that, however defined, it would be related to the 11 "criteria" which are listed in Appendix A attached.

How can one go from the estimates generated by the procedures of Part III to the criteria listed in Appendix A?

Here again, one is thrown back on the "decision rule" approach. That is to say, one has to find the areas where the "second-round" commission rate changes hit hardest, and one has to articulate how he thinks these changes will affect the various quantitative measures that are associated with the "public interest criteria". To lend substance to the approach, consider a set of such decision rules that were applied by CRI to a hypothetical commission rate change.

The hypothetical exercise in this case was intended to measure the effect of a given proposed change in commission rates upon only two indicia of "public interest" selected for illustrative purposes: The number of firms providing safekeeping facilities; and the number of firms providing research facilities. The more or less arbitrary decision rules for predicting behavioral responses to "first-round" effects of the application of the alternative rate schedule assumed:

1. Firms that experienced a decline greater than 25% in their AMEX and NYSE commission income as a result of the proposed change would go out of business.

2. Firms that experienced a loss between 5% and 25% in gross income:

a. if their ASE commission income from institutional (non-individual) customers had been greater than 30%, would terminate any research and safekeeping in which they were currently engaged;

b. if their ASE commission income from individuals had been greater than 70%, would retain any research and safekeeping activities in which they were currently engaged.

3. Firms that experienced a gain of less than 10% in income or a loss of less than 5%, would make no changes in their safekeeping and research activities.

4. Firms that experienced an increase of more than 10% would introduce research and safekeeping activities if they do not already provide these services.

Using our hypothetical commission rate schedule and our arbitrary decisions rules, and attaching them to existing data on firms' facilities and services, one was led to certain explicit conclusions; that 22 firms (all of them explicitly identifiable), would go out of business; that 57 firms, also identifiable, would add research services to the facilities available to the public; and that 17 more would offer safe-keeping services.

With a different schedule and a different set of decision rules, of course, the results generated by the process could have been quite different. But repetition and experiment with the process could begin to provide a deeper understanding of the different variables to which members and customers portrayed by the data are especially sensitive.

In the end, of course, AMEX and the SEC would still have to face up to some hard "public interest" questions. On some indicia, a proposed rate change may appear to contribute to certain aspects of the "public interest" while, according to other indicia, it appears to have an opposite effect. When different elements of the public interest point in different directions, a problem of balance or weighting exists. Nothing in the CRI EXCHANGE DATA SYSTEM can solve that difficult problem. That is a problem that will have to be faced under any approach. But the CRI EXCHANGE DATA SYSTEM can help analysts estimate the impact of different rate structures on each of several specified aspects of the public interest. With data like these in hand, the policymakers should be in a better position to perceive the public policy implications of any rate structure they are interested in, and to pick out that one which gives a "package" of effects upon the public interest—item by

item, and overall—that is preferable, in their judgment, to any other.

V. *Next Steps*

With the CRI EXCHANGE DATA SYSTEM operational, AMEX is in a greatly improved position for making reasonable, detailed judgments on the effects of any proposed commission rate change. There is a considerably more solid basis, for instance, for estimating such effects as: changes in revenue to member firms; changes in cost to the trading public; changes in member firm facilities and services; changes in the attractiveness of exchange markets relative to competing markets. Just how much light the system contributes to each of these points and others like them depends on how much the system is elaborated. Some points will always be intrinsically more difficult to explore than others; and judgment will continue to be required for all of them. But the continued use and improvement of the system cannot fail to enhance its utility and its credibility.

What is especially needed for increasing the utility of the approach is the following:

1. First and foremost, applying the analytical approach soon and often;
2. Second, extending the body of trading data that can be subjected to analysis, perhaps by updating the transactions data collected by AMEX in past periods from its members, perhaps by incorporating the parallel NYSE transactions data in the analytical system;
3. Third, extending the DATA SYSTEM itself so that a more efficient computerized link is forged between the transaction data on the one hand, and data describing the member firms and their facilities on the other. Especially important in the second category are data that describe the financial situation of such firms.

If these steps are taken, it is not hard to envisage a process by which the capacity of the exchanges and SEC to monitor the exchanges' development will be greatly enlarged. The possibility for regular rather than sporadic reviews can be envisaged. And the possibility of moving the rate-making process from the field of armchair speculation into the area of objective analysis will be greatly enhanced.

Appendix A
PUBLIC INTEREST CRITERIA AND THEIR RELATED MEASURES

Criteria	*Measures*
1. Preservation of a Central Auction Market.	1a. Place to place price differences for individual securities at a point in time.
	1b. Proportion of the trading in listed stocks that takes place at a single stock exchange.
	1c. Absolute number of stocks and proportion of stocks that are listed on the central stock exchanges.
	1d. Number of broker-dealers with access to and interest in the central stock exchanges, the geographic distribution of their offices and the size of their staffs.
2. Improvement of Self-regulation	2a. Number of instances of misconduct, manipulation, fraud and other abuses that occur and that are reported.
	2b. Proportion of security transactions that are publicly reported.
	2c. Regulatory programs of the central exchanges; disciplinary actions, complaints resolved, records maintained, training provided, personnel involved, expenditure.
	2d. Regulatory programs of broker-dealers; disciplinary actions, complaints resolved, records maintained, training

	provided, personnel involved, level of expenditures.
3. Maintenance of Public Pricing	3a. Number of buyers and sellers in the market.
	3b. Proportion of a stock outstanding in the hands of the few largest holders.
	3c. Speed, extent and accuracy with which price information is disseminated.
4. Maintenance of Incentives to Exchange Membership.	4a. Income opportunities associated with exchange membership.
5. Maintenance of the Quality of Central Markets.	5a. The average size and distribution of the price change (as a percent of price) in a security from one time period to the next.
	5b. The number of transactions in a security per period of time.
	5c. The length of time from placing an order until its execution.
6. Maintenance of Adequate Information and Related Services to Investors.	6a. The number of reports prepared, providing basic information, the consistency of reports on particular companies and the number of copies of each report made available.
	6b. Labor and other inputs devoted to research.
	6c. Number of registered representatives.
7. Avoidance of Destructive Competition.	7a. Entry and exit rates of broker-dealers into the industry.

	7b. Number of broker-dealers offering services to each group of customers (small individual investors, large individual investors and institutions) and the degree of concentration among broker-dealers serving each group.
	7c. Differences among service offerings of broker-dealers serving each group of customers.
	7d. Change in cost with each additional unit of business in the short-run and in the long run.
	7e. Cost of training and other expenditures associated with specializing resources for entry.
8. Maintenance of Opportunities for Smaller Brokerage Firms.	8a. Number of small firms in the industry and their geographic distribution.
	8b. Variety of services provided by small firms in the industry.
	8c. Cost and convenience of access to central markets by small firms.
	8d. Profitability of smaller brokerage firms.
	8e. Change in the population of smaller brokerage firms.
9. Maintenance of Extra Capacity.	9a. Variation with market volume of customer access time to registered representatives.
	9b. Variation with market volume in the execution time of orders received by registered representatives.

	9c. Variation with market volume in the reporting of executed transactions.
	9d. Variation with volume of the number of operational failures.
10. Fair Treatment of Both Large and Small Investors.	10a. Quantity and quality of services offered large and small investors.
	10b. Commissions paid by large and small investors.
11. Establishment of Lowest Commission Charges Consistent with Other Public Interest Criteria.	11a. Member firm profits on all business.
	11b. Member firm profits on each type of business.

LETTER FROM HAMER H. BUDGE DATED APRIL 2, 1970

Mr. Robert W. Haack, President
New York Stock Exchange
11 Wall Street
New York, New York 10005

Dear Mr. Haack:

In your letter of March 19, 1970 you submitted for our review pursuant to Securities Exchange Act Rule 17a-8, a proposed rule which would require member organizations to impose a surcharge in the form of a service fee of $15 or 50% of the applicable commission, whichever is the lesser, on orders of 1,000 shares or less. The Exchange states that this service charge is needed to give interim financial relief to the industry while the Commission considers the proposals for longer term revisions in the existing rate structure submitted by the Exchange on February 13, 1970.

In support of the proposed interim increase, the Exchange represents that a large number of its member organizations which do a public business sustained substantial losses in 1969 and that the situation has further deteriorated during the first quarter of 1970. Data obtained by the Commission confirms the loss experience of these firms. Past losses and the prospect of continued financial drain have influenced many member firms to impose limitations on their services to small investors. Based on studies prepared by National Economic Research Associates, Inc. as supplemented by more recent samplings of member organizations, the Exchange estimates that a surcharge of $15 limited to 50% is required to provide adequate brokerage services for small investors and to retain needed capital within the securities business.

The Commission is aware of the contribution of small investors to the depth and liquidity of our trading markets and considers it to be vital to the public interest that such investors continue to be able to participate directly in equity investment. We are also concerned with the financial problems of the industry and the losses sustained in the past year and during the first quarter of 1970. Accordingly, we will not object to the Exchange imposing an interim surcharge on rates to provide emergency financial relief while more fundamental alterations of the existing rate structure can be considered. However, we believe such action can be viewed as justifiable only if the service fee is to be imposed for a 90 day period only and will expire thereafter. This self-liquidating factor would assure that the increase will, in fact, be an interim measure. Its continuance for more than one quarter will require a review of the economic conditions, including transactions volume levels, existing at that future time.

The Commission expressly predicates its non-objection to the interim increase in charges upon its expectations that the Exchange will take all steps necessary to assure that full brokerage services for small investors are restored and that transactions size and other limitations on such accounts imposed in the last year by the Exchange's membership will be removed. We also expect that the Exchange will undertake to make certain that the additional revenue produced by the interim surcharge will be received by the member firms obtaining the customer's order and will be prudently employed by its member organizations to improve their operations and financial position.

Lastly, we wish to emphasize that the Commission's action is based on our understanding that immediate financial relief is required. Our study of the existing commission rate structure will continue and we shall also monitor the operations of the interim fee arrangement. A full examination of the proposals for longer term revisions

in the rate structure will be made as expeditiously as possible. In this regard, the Commission expects that the Exchange will promptly comply with our request to make available all underlying data and materials required for such review.

Sincerely,

s/Hamer H. Budge

Dictated over the telephone by
Sheldon Rappaport, SEC - 4/2/70.

LETTER FROM RALPH S. SAUL DATED APRIL 2, 1970

Mr. Irving M. Pollack, Director
Division of Trading and Markets
Securities and Exchange Commission
Washington, D. C. 20549

Dear Mr. Pollack:

Enclosed for filing pursuant to Exchange Act Rule 17a-8 are three copies of new Rule 396 adopted by the Board today, requiring member firms to impose a service charge on all transactions executed on the Exchange for non-members or allied members. This charge is to equal $15 for each order but in no instance to exceed 50% of the present non-member commission.

On March 26, 1970, the Exchange submitted a statement supporting the need for an increase in financial revenue for its member organizations. The Exchange wishes to make this rule effective on April 6, 1970 if the Commission accelerates the filing period required by Rule 17a-8.

The Exchange understands that if Commission approval is granted, it is conditioned upon Exchange acceptance of the conditions outlined in the letter of April 2, 1970 from Chairman Budge to Mr. Robert Haack, President of the New York Stock Exchange and as discussed with the Commission's staff.

If you have any questions, please call me.

Sincerely,

Ralph S. Saul

enclosures (3)
Dictated over telephone to
Mr. Sheldon Rappaport 4/3/70

RSS:rd

Rule 396—Service Charge

In addition to the commission computed in accordance with the provisions of paragraph (a)(1) of Section 2, Article VI, of the Constitution each member or member organization shall charge and collect upon the execution on the Floor of the Exchange of any order for the purchase or sale for the account of a non-member or an allied member of 1,000 shares or less, a service charge equal to not less than the lesser of $15 or 50% of such commission. For the purposes of this Rule, an order shall be deemed to include all purchases or sales for one account of round lots or odd lots or both of a single security, on the same day, pursuant to a single order.

LETTER FROM SECURITIES AND EXCHANGE COMMISSION DTD. 4/10/70

Mr. Ralph S. Saul, President
American Stock Exchange
86 Trinity Place
New York, New York 10006

Dear Mr. Saul:

This is to advise that the Commission does not object to adoption by your Exchange of Rule 396 imposing on customers' orders in one stock on one day of up to 1,000 shares, including odd-lots which may be part of the order, a service charge amounting to the lesser of $15 or 50% of the minimum commission whichever is less. The Commission's non-objection and acceleration of the 21-day period provided in Exchange Act Rule 17a-8 is conditioned on the understanding that no member firm which traditionally has accepted small customer accounts will impose or continue any limitation on the size of a customer's order or account and that on orders of 1,000 shares or less no customer will be charged fees in excess of the minimum commission plus a service charge of the lesser of $15 or 50% of the minimum commission. A further condition is that any member firm which has charged customers more than these amounts since the initial operative date of your rule will refund such excess to its customers.

The Commission's non-objection also is conditioned on the understanding that the firm obtaining the customer's order (the "forwarder") is entitled to receive the entire service charge but that it may share the service charge with the member firm which executes and clears orders for it either on an omnibus account basis or on a fully introduced account basis; and that in no event shall the clearing or carrying firm obtain a proportionate share of the service

charge exceeding the percentage of commissions obtained by such firm pursuant to arrangements with the forwarder which existed prior to the adoption of this rule.

Sincerely,

s/Irving M. Pollack
Irving M. Pollack
Director

LETTER FROM RALPH S. SAUL DATED JUNE 29,1970

June 29, 1970

Mr. Irving M. Pollack, Director
Division of Trading and Markets
Securities and Exchange Commission
Washington, D.C. 20549

Dear Mr. Pollack:

I am writing with regard to your April 10, 1970 letter responding to the submission by the Exchange under Rule 17a-8 of Exchange Rule 396 authorizing the imposition of a surcharge. Your letter set forth conditions under which the Commission would have no objection to adoption of the rule.

A letter of the same date was sent to each of the national securities exchanges indicating "that, subject to certain conditions, the Commission has no objection to and accepts acceleration of your rule proposal imposing a surcharge for a period not to exceed 90 days on the minimum commission rates for exchange transactions." This period expires on July 5, 1970.

The Board of Governors of the Exchange considered the matter of extending the surcharge at its meeting on June 25, 1970 and concluded that the conditions outlined in the Exchange's statement to the Commission, dated March 26, 1970, concerning the urgent need for an increase in financial revenue for member organizations still pertained. Thus, the Board determined to continue the application of Rule 396 of this Exchange. The Exchange will continue to observe the conditions outlined in the letter of April 2, 1970 from Chairman Budge to Mr. Robert W. Haack, President of the New York Stock Exchange.

Since our letter of March 25, 1970 to Chairman Budge,

economic conditions among member firms have steadily deteriorated. The need for continued application of Rule 396 is urgent.

Sincerely,

Ralph S. Saul

RSS:rd
bcc: Messrs. Kolton, Walker, Watson, Birnbaum, Nash, Cheney.

LETTER FROM JAMES W. WALKER DATED JULY 16, 1970

The Honorable Hamer H. Budge
Chairman
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Dear Chairman Budge:

We are writing regarding SEC Release 8923 which announced that the commission rate hearings are being reconvened to receive submissions pertinent to the question of whether it is necessary or appropriate in the public interest, and to insure public investors adequate access to the securities market, to extend the surcharge initiated in April. We wish to respond to the Commission's invitation to submit the Exchange's views on this question.

The Amex recognizes that the service charge is only a temporary measure to enable the membership—particularly those who must serve the public—to gain a measure of urgently needed income until a decision can be made with respect to a new minimum commission rate schedule which will best serve the public interest. Indeed, with markedly lower volume since April, the revenue effects of the service charge have been so widely disappointing that an increase in the service charge could be looked upon as a step necessary to assure public access to the exchange markets. Recent Exchange research bears this out.

On March 26, 1970 the Exchange submitted material, summarized below, which the Board of Governors considered important in determining the necessity for imposing a surcharge at that time. The Exchange requested that the submission be included in the record of the commission rate hearings and believes this material should be reconsidered now in reaching a decision on continuing the surcharge.

In our submission in March we provided the Commission with the results of a survey in which the first twelve ranking member firms in volume of public business done on the American Stock Exchange were interviewed. The information which we assembled included a description of the size and nature of the business of the firms, the changes in the mix and in the emphasis of their business, their general profit and loss situations in 1969, and increases in costs and the steps taken by certain firms to discourage small ticket business.

A new survey, commenced on June 22, 1970 and recently completed, covered several additional areas as well. We sought information as to the specific results of cost reduction programs, the continued ability of the firms to provide service to small investors after cost reduction programs, the consequences of any further cost reductions as regards the firms' ability to service customers, and what, alternatives are open to these member organizations if the service charge were to be discontinued.

In general, the survey revealed that the overwhelming majority of these organizations continue to suffer substantial losses even with the additional income provided by the service charge, and that many of these firms might be forced into liquidation if the rate of loss which they have been experiencing during 1970 continues for more than a few months. In addition, we were advised by most of these organizations that they have reduced their costs to the point where any further reductions would make it imperative that they discontinue servicing the vast majority of their individual customers.

We are attaching a descriptive table setting forth the most pertinent results of this new survey. We might point out that among the more important findings were:

Nine of the twelve firms surveyed are in a loss position through the first five months of 1970. Further, two other firms would be in a loss position

were it not for the additional income provided by the surcharge.

Eight of the firms interviewed stated they could be forced to liquidate their public business within the next twelve months at their present rate of loss, even with the surcharge.

These same eight firms stated that the discontinuance of the surcharge could very much hasten the necessity to liquidate their public business under present market conditions. Further, three other firms stated that the elimination of the surcharge could have the effect of forcing them to liquidate their public business, whereas such necessity is highly improbable if the surcharge remains.

Six of the twelve firms lost money during each of the first five months of 1970. A seventh firm suffered losses in four of the first five months of this year, and in the fifth month its profit was less than $10,000 and attributable to income from two large underwritings.

With only one exception, the service charge accounted for in excess of 20% of the retail commission income of each of the firms since it has been in effect.

Strenuous efforts to cut costs are indicated by the fact that six of the firms reported that cost reduction measures which have been taken will ultimately reduce their expenses by as much as 20%.

Eight of the firms have advised that any further cost reductions would endanger their capabilities to provide adequate service to customers.

Our interviews also revealed that the number of accounts carried by the firms has not appreciably been reduced in the past year. This means that even if a large number of these accounts are inactive, substantial expenses are still

required to maintain these accounts. These expenses include such items as mailing periodic statements, collecting dividends and interest, notifying customers of important developments regarding their holdings, and transmitting proxies. Further, the cost of capital necessary to comply with the Exchange capital rules is a continuing expense. Any plan to reduce the number of accounts is not just a matter of closing out some of the smaller accounts.

Under current conditions it is difficult for some major member firms to effect further reductions of expenses of maintaining customer accounts without incurring certain risks to the firm affecting its ability to continue in business. Once a firm determines that it will no longer offer its services to some of its public customers, these and other customers hearing of it may fear that a full-scale liquidation is in process which could affect their accounts. This could begin a chain reaction wherein customers would commence demanding transfer of accounts or liquidation of their positions in the market. Employees of such a firm may fear that they are about to become unemployed and will seek employment elsewhere. All of these possibilities must be taken into account when a firm begins a major expense cutting program accompanied by a large scale closing of accounts.

In view of the foregoing, the only realistic alternative to going out of business which faces many of these houses is to alter the structure of their organizations so as to depend no longer on or service retail business. Rather they intend to concentrate on such areas as managed accounts, servicing of institutional customers, investment banking and corporate finance. One other alternative being discussed is to continue to service individual accounts, but to take formidable steps to discourage small ticket business. You will recall that a number of firms had already taken some steps in this direction before the adoption of the service charge.

With the renewal of the service charge, the large

predominantly retail houses should hopefully be able to continue to offer and provide service to the general investing public, thus keeping open the routes of access to the securities market for individual investors. Without the service charge, it is strikingly clear that a number of firms now offering a broad range of services will be placed in immediate financial jeopardy, and will move promptly to either change the nature of their business, or withdraw from the field entirely.

The public likely regards the service charge as solely an increase in the cost of buying and selling stocks. However, the commission revenue covers far more than the costs on each particular transaction. A large part of this money is needed to support the regulatory systems and the technology necessary to enable the brokerage community to furnish the range of services required by customers. This, of course, is difficult for the public customer to appreciate since it is not visible to him, and his immediate interests lie almost exclusively in the securities which are the subject of his transactions.

In summary, therefore, we urge the Commission to continue the interim service charge. As stated previously, we believe this charge is vital to permitting firms to continue to service individual accounts until such time as a new minimum rate schedule is adopted, and without it, a traumatic and unwelcome change will occur in the nation's securities industry.

We are attaching herewith summaries of the pertinent results of our most recent survey.

Sincerely yours,

James W. Walker, J.

Attachments

SOME ASPECTS OF IMPACT OF SURCHARGE
ON SELECTED MEMBER FIRMS
[Based on Survey of First Twelve Ranking
Member Firms in Volume of Public Business
Done on ASE]

Firm	*%of 1969 Volume On ASE*	*Number of Branch Offices*	*Approximate Number of Registered Representatives*
A	1.11	63	800
B	2.01	59	650
C	1.98	64	720
D	2.49	101	1,500
E	1.77	94	1,100
F	4.14	127	1,600
G	1.79	57	980
H	1.78	69	1,200
I	2.74	95	1,500
J	2.99	98	1,450
K	2.59	83	1,300
L	7.87	183	3,800

FIRM	NUMBER OF MONTHS IN WHICH LOSS SUFFERED FROM 1/1/70—5/31/70	PROFIT OR LOSS POSITION FOR FIRST 5 MONTHS OF 1970	APPROXIMATE % OF RETAIL COMMISSION INCOME DUE TO SUR-CHARGE	APPROXIMATE REDUCTION IN EMPLOYEES FROM 7/1/69—5/31/70
A	2	Profit	24%	50
B	5	Loss	23%	900
C	1	Loss	18%	50
D	5	Loss	24%	400
E	5	Loss	23%	600
F	5	Loss	24%	1000
G	0	Profit	22%	50
H	2	Loss	24%	350
I	5	Loss	24%	700
J	5	Loss	24%	300
K	4	Loss	22%	450
L	0	Profit	21%	400

FIRM	PROJECTED ESTIMATE OF % OF EXPENSE REDUCTION SINCE JANUARY 1970	MARGIN FOR FURTHER COST REDUCTION WITHOUT ENDANGERING SERVICE CAPABILITY	PROSPECT OF OBTAINING NEW CAPITAL UNDER PRESENT CONDITIONS	FIRM WILL BE FORCED TO DISCOURAGE SMALL-TICKET BUSINESS IF SURCHARGE DISCONTINUED
A	10%	Limited	Nil	Yes
B	20%	None	Nil	Yes
C	5%	Limited	Nil	Yes
D	15%	None	Nil	Yes
E	20%	None	Nil	Yes
F	20%	None	Nil	Yes
G	10%	Limited	Limited	Yes
H	20%	None	Nil	Yes
I	20%	None	Nil	Yes
J	20%	None	Nil	Yes
K	15%	None	Nil	Yes
L	5%	Substantial	Fair	Unlikely

FIRM	FIRM WILL CHANGE MIX AND EMPHASIS OF BUSINESS IF SURCHARGE IS DISCONTINUED	FIRM MAY BE REQUIRED TO REDUCE SERVICE CAPABILITY IF SURCHARGE IS DISCONTINUED	ELIMINATION OF SURCHARGE COULD CAUSE OR HASTEN NECESSITY TO LIQUIDATE PUBLIC BUSINESS
A	Yes	Yes	Yes
B	Yes	Yes	Yes
C	Yes	Yes	Yes
D	Yes	Yes	Yes
E	Yes	Yes	Yes
F	Yes	Yes	Yes
G	Yes	Yes	Yes
H	Yes	Yes	Yes
I	Yes	Yes	Yes
J	Yes	Yes	Yes
K	Yes	Yes	Yes
L	Possibly	No	No

EXHIBIT "N"

For Release Thursday, July 2, 1970

Securities and Exchange Commission
Washington, D.C. 20549

Securities Exchange Act
Release #8924

The Securities and Exchange Commission today announced that its commission rate structure hearing will reconvene at 10:00 a.m., July 20, 1970, at the Commission's headquarters 500 North Capitol Street, Washington, D.C. 20549, to receive testimony and other relevant data concerning the proposed new minimum commission rates of the New York Stock Exchange, which have been published in Exchange Act Release #8920, and other proposals which have been or may be presented. The Commission has requested representatives of the New York Stock Exchange to appear at that time to present such testimony and relevant data. The Commission invites the other Exchanges and other interested persons to submit their views and requests in persons who may wish to present testimony or data to file appropriate summaries of their proposed presentation with the Secretary of the Commission.

EXHIBIT "O"

LETTER FROM AMERICAN STOCK EXCHANGE DATED JULY 16, 1970

The Honorable Hamer H. Budge
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Budge:

I am responding to your suggestion at our meeting of July 1 with the Commission that we outline our views as to the importance of the commission rate-making process, and the relationship of that process to the functioning of exchange markets and the regulation of securities markets. We believe that the sources of income derived by brokers and dealers functioning in the nation's securities markets are a vital part of the markets themselves and must be considered in that context in attempting to resolve the various problems relating to the minimum commission rate schedules of national securities exchanges. So far in the pending hearings little attention appears to have been focused on this important aspect of commission rates.

The Income of "Market Professionals" is Governed by the Relationship of the Parties in Securities Transactions

The form of compensation or income that a broker or dealer receives as a result of acting in a securities transaction depends upon the nature of the relationship between the parties to the transaction. If a broker acts as an agent for his customer, he receives a commission; when he acts as a dealer in a principal transaction, he derives his income from the difference between the purchase and sales price of a security, or the "spread". This is true whether the customer is a member of the public or another broker-dealer.

The Securities Exchange Act defines brokers and dealers—the "market professionals"—as a class apart from the public, and provides for pervasive regulation of their activities in the securities markets. They act as the intermediaries between members of the investing public, and between issuers and the public, in effecting transactions in the regulated securities markets.

"Market Professionals" Participate in Various Market Systems

"Market professionals" normally function in a number of different market systems. These systems include the exchange markets, the new issue market, the registered secondary market, the distribution of investment company, shares, and the over-the-counter market, which is largely a dealer market. Within the limits of financial ability and professional qualifications, brokers and dealers may function in both capacities in any or all market systems.

Income of "Market Professionals" is Regulated in All Market Systems

The amount of income the "market professional" receives in a securities transaction is subject to some regulation in all market systems. In the over-the-counter market, standards apply to the maximum "spreads" of dealers and to the amount of commissions charged by brokers in connection with transactions which are subject to the Rules of Fair Practice of the NASD. Thus, the markup policy of the NASD limits the amount of income which a "market professional" may derive from a transaction in most market systems, except the exchange markets. In general, the NASD markup policy permits "spreads" in dealer transactions, or commissions in agency transactions, of up to 5% of the value of a transaction, an amount which considerably exceeds the average commission on an exchange transaction. Dealer "spreads" in the distribution of investment company shares are regulated under Section 22 of the Investment Company Act of 1940.

In the exchange markets, minimums apply to the commissions charged and are enforced by the regulatory authority of the exchanges. These minimums for many years have averaged slightly over 1% of the dollar value of the transaction.

These legal and regulatory patterns mean first, that a broker-dealer's income is derived either through his commissions, or his "spreads"; second, a broker-dealer may, and often does, function as such in all securities markets; and, third, the sources of his income as a broker-dealer in different markets are regulated to varying extents, and his income as a percent of the value of a securities transaction is potentially much greater in markets other than exchange markets.

Distinction of Market Systems in Terms of "Market Professionals" Income

In the absence of market organization for a contrary purpose, a dealer could be expected to participate directly in all transactions involving the public. The opportunity for customers to meet through their agents to effect a transaction would rarely occur. Organizing a market system to promote the frequency by which customers meet through their agents produces an exchange or agency-structured market system. The effect, of course, is to subordinate the role of the "professional" dealing for himself in such a market system.

As we view the broad policy objectives and actions of the SEC over the years, it appears that the Commission has, in the public interest, favored the subordination of "professionals" dealing for their own account in favor of an agency system of markets. Therefore, in the context of the present commission rate hearings, any steps taken by the Commission that would weaken an agency-structured market system would seem inconsistent with the policy pursued by the SEC for nearly 40 years.

"Market Professional" Income is Integral Part of Agency-Structured Market System

In arriving at reasonable commission rates for an exchange market, it is necessary that rates be set at levels which will bind the "market professional" to an agency-structured system, and induce him to forego the profit potential that may be derived from acting as a dealer in another market system. Equally, the system must be sufficiently efficient to provide reasonable assurance that fixed minimum commission rates will, in the long run, be financially rewarding. Finally, the rate must be such that the cost to the customer of the total transaction will not exceed what he would pay in effecting his transaction in another system.

Therefore, uniform commission rates in exchange markets which become "unreasonable" become economically unsound as well. The "market professional" who functions in most cases as a dealer in other market systems, and who is also a member of and responsible for the exchange system, must be able to respond to a commission rate structure which, among other things, assures the survival of the system. Indeed, exchange governors have as their primary duty the "promotion of the welfare, purposes and objects of the Exchange" which is further defined "to provide a securities marketplace where high standards of honor and integrity shall prevail and to promote and maintain just and equitable principles of trade and business'.

In this context, commission rates which become too high permit dealer competition to arise away from the exchange system. Such commission rates, therefore, cause a loss of business and a weakening of the system through the fracturing of the market. In the final analysis, they would be "excessive" to the customer who would take his business elsewhere. On the other hand, a rate which is too low destroys the "market professionals" incentive for membership because of the unattractive income potential.

Commission rates are developed by the governors of an exchange who are aware of these opposing forces and of their own responsibilities. They must develop rates to meet the needs of an exchange market that is only one of a number of market systems. In developing these rates, they have available not only cost figures and other data, but also broad knowledge and experience in other market systems. In our view, it is therefore more important to examine in detail—and be satisfied with—the process by which rates are developed, than it is to adopt some formula related to costs or volume.

To the extent that those involved in the development of rates are competitors in various market systems; sharply different views must be reconciled in the process of developing commission rates for an exchange. Moreover, the process that is followed, the facts that are developed to support commission rates, and the judgments that are finally made are subject to SEC oversight. This provides an independent judgment, in the public interest, of the fairness of the rates and of the process by which they have been developed.

Conclusions

From the foregoing analysis, two broad observations can be made: one concerns the SEC interest in the agency-structured market system; and the second concerns the method that may be employed to improve rate making in the context of regulating securities markets.

If one accepts all, or even part, of the reasoning outlined above, it follows that the SEC has a vital interest in assuring that a securities market system which

> permits public buyers and sellers to meet through their agents in a central marketplace to the greatest extent possible;
>
> encourages an agency market where transactions

are effected at or between the quoted bid and asked price rather than outside the published bid and asked price as in most dealer markets;

subordinates the role of the "professional" dealing for his own account in the market to that of the customer represented by his agent and thus tends to reduce the potential for conflicts of interest by the parties to a transaction;

provides uniform, non-discriminating rates for users of the markets;

avoids the concentration and the need for excessive amounts of capital inherent in a dealer-structured market;

provides for disclosure to the public of the price, volume and time of the transaction,

which, in short, incorporates characteristics to serve best the vast majority of public investors should not, in the public interest, be permitted to atrophy or be discarded unless it can be clearly established that a better market structure, meeting these and similar tests of market quality, has been developed.

We believe that consideration of the exchange market system as an agency-structured market and of the public benefits inherent in such a market system was given by the Congress when it enacted the Securities Exchange Act of 1934, and when it accepted the principles of self-regulation and the commission rate-making process bound up with the functioning of exchange markets. Indeed, it is difficult to rationalize the action of the Congress at that time in any other way.

As to what may be done to improve the rate-making process, we outlined a suggested detailed procedure in our March 26, 1970 submission to the Commission. This procedure included the possibility of requiring a national securities exchange, prior to imposing a minimum commission rate schedule, to file with the Commission a plan

disclosing the process by which such rates are to be determined, the frequency with which rates are to be reviewed, and the method of regulating those rates to assure uniformity of interpretation and enforcement. Such a procedure would permit the Commission to take a proper flexible approach to this important aspect of market regulation, to see that appropriate changes in rate schedules are effected when the need is demonstrated, and to require that exchanges be responsive to changing conditions and to constructive suggestions of interested parties.

In this connection, we urge the Commission to consider the various steps taken by the New York Stock Exchange in developing its new commission rate schedule submitted on June 30, 1970. We believe that the procedures recently followed by the New York Stock Exchange, although not formalized by rule, closely parallel many of the features which we have proposed for improving the rate-making process.

While the American Stock Exchange did not participate in the development of that rate schedule, we believe a careful analysis of the procedures followed will demonstrate the extent to which efforts were made to arrive at fair levels of commissions, while at the same time giving appropriate attention to the public interest objectives of the central agency market. We therefore strongly urge the Commission to give favorable consideration to the new rate schedule submitted by the New York Stock Exchange so that it can be implemented at the earliest possible time. At the same time, changes in the rate-making process may be worked out to bring the commission rate hearings to a conclusion.

Because of time considerations and the urgency of dealing with the overall commission rate problem as soon as possible, I am submitting this outline and our suggestions informally in the hope that it may be helpful in

resolving present commission rate problems, and in charting a course for dealing with these problems in the future.

Sincerely,

s/James W. Walker, Jr.

cc: The Honorable Hugh F. Owens
The Honorable A. Sydney Herlong, Jr.
The Honorable Richard B. Smith
The Honorable James J. Needham

EXHIBIT P

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

March 17, 1971

Mr. Ralph S. Saul, President
American Stock Exchange
86 Trinity Place
New York, New York 10006

Mr. James E. Dowd, President
Boston Stock Exchange
53 State Street
Boston, Massachusetts 02109

Mr. A. W. Ault, President
Cincinnati Stock Exchange
209 Dixie Terminal Building
Cincinnati, Ohio 45202

Mr. Peter M. McPherson, President
Detroit Stock Exchange
2314 Penobsest Building
Detroit, Michigan 48226

Mr. Michael E. Tobin, President
Midwest Stock Exchange
120 South La Salle Street
Chicago, Illinois 60603

Mr. Edward T. McCormick, President
National Stock Exchange
91 Hudson Street
New York, New York 10013

Mr. Thomas P. Phelan, President
Pacific Coast Stock Exchange
301 Pine Street
San Francisco, California 94104

Mr. Elkins Wetherill, President
Philadelphia-Baltimore-Washington Stock Exchange
17th Street and Stock Exchange Place
Philadelphia, Pennsylvania 19103

Mr. George J. Potter, President
Salt Lake Stock Exchange
39 Exchange Place
Salt Lake City, Utah 84011

Mr. G. C. George, President
Spokane Stock Exchange
206 Radio Central Building
Spokane, Washington 99204

Gentlemen:

This letter, separately addressed to each of the registered national securities exchanges other than the New York Stock Exchange, relates to the Commission's advice to the New York Stock Exchange that minimum non-member and intra-member commission rates on large, institutional size orders are neither necessary nor appropriate. Copies of the Commission's letters to the New York Stock Exchange on this subject (Exchange Act Release Nos. 9007, 9079, 9096 and 9105) are enclosed for appropriate consideration by your Exchange.

We, of course, will expedite consideration of any filings on this subject which your exchange may make pursuant to Rule 17a-8 so that they may become effective on or before April 5, 1971.

Sincerely,

s/Irving M. Pollack
Irving M. Pollack
Director

Enclosures

LETTER FROM RICHARD B. SMITH DATED OCTOBER 22, 1970

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

The Commission has reviewed the proposed New York Stock Exchange minimum commission rate schedule which it received June 30, 1970, and the evidence presented in the public hearings on that subject. As a result of its review, the Commission has concluded that the following segments of the schedule are not reasonable:

(1) *Commissions to be charged for orders of 100-400 shares.*

The Commission believes that the schedule proposed for orders of 100-400 shares is unreasonable in terms of the percentage increase it represents over the present minimum commission rate schedule and the rate of commissions charged more recently with the imposition of the interim service charge in addition to the present schedule. Investors purchasing this number of shares would be required, under the proposal, to bear an inordinate amount of total commission increase sought by the Exchange. The Commission has determined that increases in these particular minimum commission rates would not be unreasonable if they were reduced in the 100 through 400 share order categories at the $40 per share price level, as shown in the schedule below, with proportionate reductions for other price levels in these share order categories.

Number of Shares	*Proposed Increase of*	*Reduced To*
100	50%	37%
200	45%	34%
300	35%	26%
400	25%	20%

(2) *Commissions to be charged for portion of orders exceeding $100,000 or more.*

The Commission is of the opinion that fixed charges for portions of orders in excess of $100,000 are neither necessary nor appropriate.

The Commission believes that the remainder of the proposed schedule is not unreasonable and that the schedule, if adopted as modified as suggested in (1) and (2) above, will afford member firms an income consistent with their interests and the interests of investors and the public at large. The Commission's action is in part predicated upon the need for member firms to adequately service the small investor and, accordingly, is conditioned on the understanding that no member firm which traditionally has accepted small customer accounts will impose or continue any limitation on the size of such customer's order or account and that in connection with such business the firm will not charge fees in excess of the proposed rates. The Commission also expects that the Exchange will take all steps necessary to assure that these revenues will be prudently employed by all of its member organizations to improve their operations and financial position.

Consistent with the representations made by the Exchange of the need for continuous review of commission charges, the Commission will re-examine the level and structure of rates for the period following July 31, 1971. For this purpose, the Commission requests the Exchange as soon as possible but no later than June 30, 1971, to present

for Commission consideration a new rate schedule of scaled percentage charges based upon the amount involved in an order. Such a rate schedule should be fair, readily understnadable and not present undue problems of administration.

The Exchange also is requested on or before that date to present a plan for reasonable economic access to the New York Stock Exchange for non-member broker-dealers. Further, the Exchange is requested on or before June 30, 1971, to submit appropriate revisions relating to intramember rates.

Finally, the Commission considers it to be necessary to the continuance of a system of fixed rates for exchange transactions that a uniform system of accounts as well as uniform and adequate methods of cost allocations be implemented. Accordingly, the Exchange should present at the earliest practicable date and not later than May 31, 1971 a plan for such uniform accounting system. At the same time, the Commission will be considering such a plan for all registered broker-dealers.

If the Commission or its staff can be of assistance to the Exchange in regard to our suggested modifications of its proposed schedule, please let us know.

Sincerely,

Hamer H. Budge
Chairman

RELEASE Thursday, February 11, 1971

Securities and Exchange Commission
Washington, D. C. 20549

Securities Exchange Act of 1934
Release No. 9079

The Securities and Exchange Commission today announced that it has concluded that the New York Stock Exchange should take immediate action to implement by April 1, 1971 the Commission's finding that fixed minimum commissions on large institutional size orders are neither necessary nor appropriate. (That finding was contained in a Commission letter of October 22, 1970 to the New York Stock Exchange which was published as Securities Exchange Act Release No. 9007.) The Commission also concluded that, in light of substantial changes in trading patterns on the New York Stock Exchange and to gain further experience with competitive rates, it would not object if that Exchange provided for competitive rates on portions of orders above a level higher than the $100,000 figure mentioned in its October 22, 1970 letter but that the point at which competitive rates are to commence should not exceed $500,000. The Commission also made clear that it saw no reason for delay by the New York Stock Exchange in initiating competitive rates on such orders until that Exchange determines whether and how its rules regarding institutional membership should be amended.

The Commission's letter of February 10, 1971 to the Exchange in response to a February 3, 1971 letter from the Exchange follows:

February 10, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

As your February 3, 1971 letter indicates, in early January the Commission advised representatives of the Exchange that delay in implementation of the elimination of minimum commission rates on large orders for the purpose of enabling the Exchange to undertake a study of whether such action should be taken was unacceptable.

You have described in some detail concurrent and subsequent activities of the Exchange's Committee on Membership Qualifications concerning institutional membership. We see no reason why the Costs and Revenues Committee's or the Board's resolution of the competitive rate issue "must logically await the development of definitive recommendations" respecting institutional membership. As you know, we did not suggest in our October 22, 1970 letter, nor do we now suggest that Exchange action on the implementation of competitive rates for institutional size orders should await resolution of various issues referred to in the Commission's October 22 letter or of questions concerning Exchange Rule 318.

Accordingly, particularly in view of the time that elapsed since the Commission's letter of October 22, the Commission believes that the Exchange should take immediate action to implement, by April 1, 1971, the Commission's finding that fixed minimum commissions on institutional size orders are neither necessary nor appropriate. In light of substantial changes in trading patterns on the New York Stock Exchange and to gain further experience with competitive rates, the Commission will not object to the

Exchange's commencing competitive rates on portions of orders above a level not higher than $500,000 rather than at the $100,000 figure mentioned in our October 22 letter.

Sincerely,

Richard B. Smith
Commissioner

February 3, 1971

The Honorable Hugh F. Owens
Commissioner
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Commissioner Owens:

In accordance with your request, the purpose of this letter is to bring the Commission up to date on developments with respect to changes in NYSE commission rates since our letter of December 23, 1970.

In our letter of December 23, we responded to the Commission's comments of October 22 on the Exchange's minimum commission schedule which we submitted to the Commission on June 30, 1970. Our response included a proposed new interim service charge, contained in a revision to Exchange Rule 383, which the Board of Governors had approved, in principle, on December 23 for discussion with the Commission.

In our December 23 letter, we also responded to the other comments made in the Commission's October 22 letter by stating:

> "The Commission's October 22 letter also suggests that fixed minimum charges for portions of orders in excess of $100,000 are neither necessary nor appropriate. It is our understanding that the Commission was not suggesting that fixed

> rates on portions of orders above $100,000 be eliminated immediately but rather that it expects the Exchange to comment on the Commission's suggestion within a reasonable period of time. We, therefore, propose to undertake, with the cooperation of the Commission, a study of a proposal that a maximum level of fixed rates be made a part of the Exchange's minimum commission rate schedule.
>
> "Similarly, the Costs and Revenues Committee will begin a review of the other issues raised in the Commission's letter in order that the Exchange may respond to the questions of access for non-member broker-dealer, intra-member rates and a uniform system of accounts and cost allocations by the dates set out in the Commission's letter of October 22."

In early January, representatives of the Exchange had a number of discussions both with the Commission and its staff which led us to conclude that the SEC favored a delay in commenting on the proposed interim service charge until additional public hearings could be held. Further, it was indicated that the Commission staff might view an extension of the modified service charge—which would have applied to all orders—akin to a commission rate change, and, accordingly, could be implemented only by amending the Exchange Constitution and submitting the proposal to the membership for balloting.

More important, however, the Commission indicated that the suggestion in our December 23 letter, as quoted above, that a study be undertaken of the elimination of fixed minimum commission rates on large transactions was not acceptable.

As a result, it appeared to us that further consideration of these issues by the Exchange's Costs and Revenues Committee was required.

While these discussions were in progress in early January, the Exchange's Committee on Membership Qualifications was also working intensively to develop recommendations concerning institutional membership on the Exchange. On January 25, the Committee agreed, in principle, "that under appropriate conditions subject to self-regulatory practices, institutional membership is desirable on the New York Stock Exchange when coupled with competitive commission rates on trades at some amount to be determined." The Committee directed the staff of the Exchange to recommend a specific course of action to implement this decision. A Subcommittee on Rules was created to provide the staff with policy guidance and to consider staff reports.

Since January 25, the Subcommittee has held several meetings and a staff task force has been working diligently to carry out the directions of the Committee on Membership Qualifications.

Under the Exchange's procedures, recommendations concerning competitive rates must be considered by the Costs and Revenues Committee. It seems that a resolution of the competitive rate issue must logically await the development of definitive recommendations by the Committee on Membership Qualifications.

It is the present intention of the Subcommittee on Rules to develop specific proposals relating to institutional membership for submission to the full Committee on Membership Qualifications at the earliest possible date. Any action by the full Committee must then be submitted to the Exchange's Board of Governors for their consideration. The earliest date specific proposals with respect to constitutional membership could be considered by the Board of Governors is February 18, the next policy meeting of the Board.

Progress clearly depends upon the speed with which the Subcommittee and staff can complete their work and gain

approval of the full Committee.

It may be that proposals with respect to competitive rates could be considered by the Board of Governors at the same time the issue of institutional membership is brought before the Board. In fact, some members feel that competitive rates on some trades should be an integral part of any institutional membership proposals and the two issues must be considered and resolved at the same time.

As I am sure the Commission appreciates, these are terribly complicated issues, there is little data on the impact, and both issues are highly controversial within the securities industry. Nonetheless, we are proceeding as rapidly as possible, as I think this recitation of recent developments demonstrates. We will keep the Commission advised of our progress. In the meanitme, if the Commission has any suggestions in these areas which will assist in our consideration of these complex issues, we will be pleased to hear from you.

Sincerely,

Robert W. Haack

For RELEASE Thursday, March 4, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

Securities Exchange Act of 1934
Release No. 9096

The Commission today announced that it has sent a letter dated March 2, 1971 to the New York Stock Exchange making clear that there is no justification for the fixing of intra-member minimum rates for floor brokerage and clearance on the portion of orders which will be subject to competitive non-member stock exchange commission rates. The Commission had previously called for the Exchange to implement competitive non-member rates on large, institutional-size orders in its letters of October 10, 1971 (Exchange Act Release No. 9079). The Commission's March 2 letter follows:

March 2, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

We have received inquiries concerning the matter of NYSE intra-member rates for floor brokerage and clearance on portions of orders above the level at which the Exchange will provide for competitive rates pursuant to our February 10, 1971 letter. While that letter did not explicitly so state, the Commission believes it is clear that there is no justification for the fixing of intra-member rates on the portion of orders which will be subject to competitive nonmember rates.

We understand that a subcommittee of the Cost and

Revenues Committee has been established to consider the matter of intra-member rates. We expect that the subcommittee, the full committee and the Board will take action to assure that competitive intra-member rates also will be implemented by April 1, 1971 on portions of orders to which competitive nonmember rates will apply.

In addition, we are gratified that a subcommittee has been established to develop for presentation to the Commission by no later than June 30, 1971 a proposed revision of the intra-member charges for floor brokerage and clearance as requested in our October 22, 1970 letter. In view of the expressions of concern by non-clearing members of your Exchange about the propriety of existing intra-member minimum rates, we expect, should the Exchange propose an intra-member minimum rate schedule for floor brokerage and clearance, it will present an adequate self-regulatory rationale for the proposed schedule and that there will be fair representation of non-clearing firms on any subcommittee which may develop such a schedule.

Sincerely,

Hugh F. Owens
Commissioner

For RELEASE Thursday, March 11, 1971

Securities and Exchange Commission
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 9103

The Securities and Exchange Commission today announced that it had yesterday sent a letter to the New York Stock Exchange reaffirming the conclusion in its March 8, 1971 letter that the continuation of minimum commission rates on portions of orders above $500,000 beyond April 2, 1971 would be unreasonable and would be contrary to the Exchange Act. The Commission requested the Exchange to so advise its members and stated that the conclusions reached in the Commission's March 8 letter are not altered by the timing of the Exchange's procedural steps to amend its constitution or their outcome. The Commission's March 8 letter, the New York Stock Exchange's response of March 9 and the Commission's reply of March 10 follow:

March 8, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

As you will recall, on November 9, 1970 you wrote to the Commission stating the Exchange's assumption that the Exchange and its members would have a reasonable time to thoroughly study the conclusion in the Commission's October 22, 1970 letter that minimum commission rates on large, institutional size orders are neither necessary nor appropriate. On February 10, 1971 the Commission wrote to you that we would not object if competitive rates were to apply to the portion of orders which exceed a cut-off point of not more than $500,000 and stated that the Exchange

should take immediate action to implement such competitive rate by April 1, 1971.

We understand that the Exchange and its members have very recently been addressing themselves to a number of questions relating to competitive rates which are not yet resolved. Of course, the matter of competitive rates and related questions have been before the Exchange and its membership since October 22, 1970. The Commission appreciates that, as in other situations such as when the surcharge was adopted, the Exchange necessarily will be able to take appropriate interpretive action after as well as before rule changes are adopted.

As the Commission has previously advised the Exchange, the time to implement such competitive commission rates would not extend beyond April 1. However, if operational problems would result from the change occurring during the middle of a business week, the Commission will not object to the Exchange retaining minimum commission rates on such orders through April 2, 1971. Accordingly, your members should be advised promptly that the continuation of minimum commission rates on those portions of such orders beyond that time would be unreasonable and would be contrary to the Exchange Act.

Sincerely,

FOR THE COMMISSION
Hugh F. Owens
Commissioner

March 9, 1971

The Honorable Hugh F. Owens
Office of the Commissioner
Securities and Exchange Commission
500 N. Capitol Street
Washington, D. C. 20549

Dear Commissioner Owens:

As per our discussion with the Commission yesterday morning, and in response to your letter of March 8, we appreciate the opportunity to outline to the Commission what the Exchange is doing to implement competitive rates on orders exceeding $500,000.

Before such a change can be made it is necessary to amend Article XV of the Exchange Constitution dealing with "Commissions and Service Charges." Article XX of the Exchange Constitution contains the procedure which the Board of Governors must follow in proposing amendments to the Constitution. Amendments to the Constitution can only be approved or disapproved by the Exchange membership.

Article XX of the Constitution provides that every proposed amendment to the Constitution must be presented in writing at a regular meeting of the Board or at a Special Meeting called expressly for receiving it. Upon presentation, the proposed amendment must be laid upon the table for at least two weeks. After the minimum two week posting period, the Board of Governors may approve the amendment and submit it to the membership for a vote.

Article XX also provides that the time for balloting shall expire at the end of two weeks following approval and submission of the proposed amendment by the Board of Governors, unless at the end of the two week period less than a majority of the then members have participated in the balloting.

Accordingly, a minimum period of four weeks is required, assuming membership approval, to amend the Exchange Constitution. In addition, Exchange Rule 26 provides that in the case of amendments to Article XV of the Constitution "the text of such amendment shall be posted on the bulletin board, distributed to the membership and publicly announced at least 30 days before action thereon is taken by the Board of Governors." In other words, Rule 20 has the effect of extending the minimum posting period for amendment to the commission Article of the Constitution to 30 days rather than the two weeks required for amendments to other Articles of the Constitution.

The timetable which we have been following, as explained to the Commission at the meeting yesterday morning, calls for a series of meetings to be held with various groups dealing with aspects of the problems which have been raised in connection with the new structure of commission rates which will come into being with the establishment of competitive commission rates. A meeting was held yesterday with representatives from the operational side of the business, and meetings were held today with counsel on the legal questions which have been raised.

A meeting is to be held on intra-member rates in view of the Commission' letter of March 2, which we received last Wednesday, notifying the Exchange that it expected that fixed intra-member rates above tiie $500,000 level would also cease to apply.

A meeting of the full Costs and Revenues Committee is scheduled for this Thursday, March 11, to review the various recommendations which will hopefully be developed as a result of the consideration of the various problems which are being explored.

We recognize, as the Commission states in its letter of March 8, that the Exchange will be able to take ap-

propriate interpretative action after as well as before rule changes are adopted. However, here we are dealing with a new structure of commission charges which, in effect overturn commission rates and practices which have existed in the securities industry for many, many years. In our review we have been attempting to visualize the practices which might arise under a scheme of competitive rates. It may be that some of these practices will be inimical to the public interest and therefore must be addressed by the Exchange prior to the implementation of a new commission structure rather than to react to practices after abuses occur.

We are not, as has been repeatedly emphasized to the Commission and its staff, proposing that the implementation of competitive rates be delayed for the sake of delay. We do feel, however, that as thorough an exploration of the problem areas as is possible should be done in the shortest possible time.

As we stated at the meeting with the Commission yesterday, we are proposing that a proposed amendment to the Exchange Constitution be laid upon the table at the policy meeting of the Board of Governors on March 18. As you know, out-of-town members and the three public members of the Board of Governors do not ordinarily attend the weekly meetings of the Board and major matters are reserved for the Board at the policy meeting held on the third Thursday of the month.

When the proposed amendment is laid upon the table at the policy Board meeting on March 18, we also plan to propose that the Board repeal Exchange Rule 26 and thereby shorten the posting period from 30 days to two weeks. After the expiration of the minimum two week posting period, we will move that the Board approve the proposed amendment and submit it to the membership for balloting. As explained previously, the minimum two week balloting period would expire on Thursday, April 15, if this schedule is adhered to.

We have asked the Exchange's counsel, Milbank, Tweed, Hadley and McCloy, for its opinion on the legal impact of the last sentence of your letter of March 8, 1971, before any notice is sent to the Exchange membership.

We hope that the Commission appreciates that we are working diligently on the questions raised by the implementation of a scheme of competitive rates and that the Board of Governors of the Exchange must, absent appropriate commission action under Section 19(b) of the Securities Exchange Act of 1934, adhere to the requirements of the Exchange Constitution in effecting changes in commission rates.

This means that it will not be possible for the Board of Governors, acting under the requirements of the Exchange Constitution, to implement competitive rates on orders exceeding $500,000 prior to April 1 or April 2, but that such rates can be made effective as early as April 16. However, since April 16 is a Friday, for operational reasons it would be advisable to make the change effective on the following Monday, April 19.

In view of the magnitude of the proposed change, the prospect of the continuation of the existing system of fixed minimum commission rates for ten additional trading days beyond April 2 does not seem unreasonable. Whether the Commission's position is legally correct or not, it does not seem that much is accomplished by exposing the member organizations and the exchanges to potential lawsuits, which may be litigated for years, to accelerate the implementation of competitive rates on larger transactions by a few days.

We hope that the Commission will agree and advise us that it has no objection to the Exchange's retaining the existing minimum commission rates through April 16. Let me assure you that Chairman Lasker, Vice-Chairman DeNunzio and I have every intention of following through

with this schedule on March 18, if the Commission approves.

Very truly yours,

Robert W. Haack

March 10, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

This is in reply to your letter of March 9, 1971 in which you respond to our letter of March 8 with respect to commission rate structure by describing the action which the Exchange has taken and proposes to take pursuant to various provisions of your constitution to bring about a modification of Article XV of the constitution to introduce competitive commission rates on that portion of orders which exceeds $500,000. It expresses the view that all of these procedural steps cannot be concluded prior to April 16 or perhaps April 19.

If this were an initial proposition which was first called to your attention on March 8, we would endeavor to accommodate your concern. However, the Commission's determination, following extensive hearings, was brought to your attention on October 22, 1970 and on February 10, 1971 you were advised that action should be taken by April 1. Procedural steps required by your constitution could have been initiated earlier, but we are not attempting to determine the timing of the procedural steps you take pursuant to your constitution. We do, however, adhere to the statement in our letter of March 8 that the continuation of minimum commission rates on portions of orders above $500,000 beyond April 2, 1971 would be unreasonable and

would be contrary to the Exchange Act and we believe that you owe it to your members to so advise them. We assume that in view of this, the procedural steps under your constitution will be taken as rapidly as possible, but the conclusions reached in our letter of March 8 are not altered by the timing of those steps or their outcome.

Sincerely,

FOR THE COMMISSION
Hugh F. Owens
Commissioner

EXHIBIT Q

March 26, 1971

Mr. Irving M. Pollack, Director
Division of Trading and Markets
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Mr. Pollack:

The Exchange has reviewed carefully your letter of March 17, 1971 relating to the Commission's advice to the New York Stock Exchange that minimum nonmember and intramember commission rates on orders over $500,000 would be unreasonable and contrary to the Exchange Act after April 2, 1971, and your suggestion that any filings by the American Stock Exchange on this subject under Rule 17a-8 will be expedited so that they may become effective on or before April 5, 1971.

At the outset, the Exchange believes it important to express again its serious concern with the conclusions reached by the Commission concerning minimum commissions. As you know, this Exchange has not been a party to the discussions between the Commission and the NYSE and we know of no findings by the Commission which substantiate the conclusion that fixed commissions on that portion of an order exceeding $500,000 would be unreasonable or contrary to the Exchange Act.

We are also concerned that the Commission's letter of February 10, 1971 to the NYSE suggested that eliminating fixed minimum commissions on orders over $500,000 will provide an opportunity to "gain further experience with competitive rates," thus indicating that consideration may be given to lowering the $500,000 level at some future date.

The Exchange believes that the Commission's decision,

while focussing on the level of rates, does not come to grips with the deeper and more crucial issues inherent in the concept of fixed minimum commissions. In this connection, in August, 1968 we expressed in our presentation at the Commission Rate Hearings the following points:

> "First, abolishing the minimum commission would undermine the self-regulatory system that has been carefully and painstakingly developed over the last 34 years. It would undo years of progress during which cooperation between government and the Exchange has developed. It would place upon government the direct burden of regulation.
>
> "Second, if minimum commissions were abolished members would lose the economic incentives that tie them to Exchange rules and regulations designed to benefit thepublic.
>
> "Third, erosion of membership would follow the end of minimum commissions and the market itself would deteriorate as the volume of orders was reduced. It would become increasingly difficult to maintain the liquidity and continuity that are among the market's unique characteristics.
>
> "Fourth, research information and market data services which the public needs and expects would probably be curtailed.
>
> "Fifth, abolishing minimum commissions would jeopardize the efforts now underway to improve the securities industry's operations. The Exchange and member firms are pressing new projects that are required to meet future needs. These require substantial investments advanced from the membership and derived from commission income.
>
> "Thus, the possible consequences of eliminating minimum commissions pose a threat to the public and to the economy as well as to the securities

industry. It would be reckless to jeopardize the self-regulatory structure of an industry that is devoting its major efforts to meeting urgent priorities aimed at improving services to the public."

While the letter of October 22, 1970 from the Commission of the NYSE suggesting eliminating fixed minimum commissions for institutional size orders was previously forwarded to us by a member of the Commission's staff, we have not been a party to any of the subsequent negotiations between the Commission and the NYSE. As a result of articles in the press and through discussions with individuals on the staff of the Commission, we have been aware that such negotiations were taking place, but we have not previously been advised as to the applicability to this Exchange of the results of those negotiations.

Nevertheless, we have carefully considered your letter of March 17 and have determined that in view of the Commission's position, the Exchange is obliged to recommend appropriate revisions to its Constitution and Rules to eliminate fixed minimum commissions on that portion of an order in excess of $500,000.

The Exchange hopes that the position which is currently being taken by the Commission in regard to this matter will not cause serious harm to the securities markets or the investing public and that it will not result in substantial new regulatory problems.

The necessary amendments to the Exchange's Constitution and Rules are presently being prepared and it is anticipated they will be submitted to the Board of Governors at its meeting next week on April 1, 1971. If the Board approves these amendments and the Commission expedites its consideration of such amendments under Rule 17a-8, we plan to submit them to the membership for a vote as soon after April 1 as possible. Since the Exchange's

Constitution requires a two-week period for voting, these revisions to the commission rates could become effective, at the earliest, commencing with the opening of business on April 19, 1971.

We strongly urge that in the event the Commission reaches any further determination respecting the Exchange's commission rates, it will base its determinations on factual findings which are communicated to us and will afford the Exchange an opportunity to comment on such findings.

Sincerely,

s/Ralph S. Saul

RSS:rd

EXHIBIT "R"

LETTER FROM ROBERT J. BIRNBAUM DATED APRIL 28, 1971

Mr. Irving P. Pollack, Director
Division of Trading and Markets
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Dear Mr. Pollack:

Enclosed, pursuant to Exchange Act Rule 17a-8, are three copies of proposed new Rules 397 and 398.

If the Exchange's Constitutional amendments eliminating minimum nonmember and intramember rates on portions of orders in excess of $500,000 are approved by the membership, it is proposed that these Rules become effective on May 3, 1971. Thus, the Exchange is requesting acceleration of the required 21-day filing period under Rule 17a-8.

Because of operational considerations, new Rule 397 requires commissions to be charged on the basis of lowest priced executions first. New Rule 398 requires member firms to report specified information on orders which they execute when the amount involved exceeds $500,000. This will enable the Exchange to better observe the workings of competitive rates and focus on any problems that may arise.

If you have any questions, please call me.

Sincerely,

s/Robert J. Birnbaum

RJB:mvd
Enclosures
bcc: Messrs. Saul, Kolton, Walker and Nash

EXHIBIT "B"

NEW RULES

Computation of Commissions on Stocks

Rule 397. The minimum commission required to be charged under Section 2 of Article VI shall be computed on the basis of the lowest priced executions first.

Reports of Executions of Orders Exceeding $500,000

Rule 398. Promptly following the 10th day of each calendar month each member or member organization shall report the following information to the Exchange with respect to each order executed, either as principal or agent during the preceeding calendar month for the purchase or sale of any stock admitted to dealings upon the Exchange, where the amount involved in such order exceeds $500,000:

(1) the name of the stock;

(2) whether the customer of the member or member organization purchased or sold the stock. Where the member or member organization had all or a portion of both sides of the transaction this should be indicated and the amount of each side should also be indicated;

(3) whether the member or member organization acted as agent or principal, or both, and the number of shares on each side of the transaction with respect to which the member or member organization so acted;

(4) the date of execution;

(5) the market or markets where executed;

(6) the number of shares in the order and the number of shares in each execution included within the order;

(7) the commission or commissions charged on each portion of the order; and,

(8) such other information as the Exchange may from time to time require.

For the purposes of this rule, an order shall be as defined in Article XV, Section 2(f)(2) of the Constitution.

LETTER FROM THE COMMISSION DATED 3/9/72

Mr. Paul Kolton
President
American Stock Exchange
86 Trinity Place
New York, New York 10006

Dear Mr. Kolton:

As you know, the Commission's February 2 Statement on The Future Structure of the Securities Markets concluded that a reduction to $300,000 is indicated in the breakpoint above which commission rates on stock exchange transactions should be competitively determined. We indicated there that the reduction should take effect in April 1972, after a year's experience with competitive rates on the portion of an order exceeding $500,000. Since then we have received no evidence which would lead us to conclude that this reduction in the breakpoint should not take place on schedule. Accordingly, we believe that each exchange should begin to draft rule changes which may be implemented at the forthcoming March policy meeting of its Board. We will certainly advise you should evidence come to our attention between now and April which would require us to change our view on your exchange proceeding to lower that breakpoint to $300,000 by April.

The Commission's February 2, 1972 Statement further stated that "we have also determined to move toward the point at which commission rates on all orders of institutional size will be, at least in part, subject to competitive rates." In view of the possibility of future Commission requests for further reductions in the breakpoint level, your exchange should at this time make any rule changes necessary to enable it to comply promptly with such requests.

Sincerely,

s/William J. Casey
William J. Casey
Chairman

LETTER TO MR. POLLACK DATED 3/28/72.

Mr. Irving Pollack
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Dear Mr. Pollack:

Enclosed for filing pursuant to Exchange Act Rule 17a-9 are three copies of amendments to the American Stock Exchange Constitution and Rule 398 to effect the reduction of the breakpoint for negotiated rates to the $300,000 level.

Chairman Casey, in his letter of March 9, 1972 to Mr. Paul Kolton, pointed out that the Commission's February 2nd Statement on the Future Structure of the Securities Markets concluded that this reduction should take effect in April.

In addition, we understand that the New York Stock Exchange has acted with respect to a similar letter addressed to that Exchange to effect comparable changes to become effective with trades of April 24th.

Accordingly, we request acceleration of the normal 21-day review period in order that the proposed amendments may be formally approved by the Board of Governors at its next meeting to be held Wednesday, March 29th. This would permit implementation of the new $300,000 breakpoint on the same date as the New York Stock Exchange, thus minimizing programming problems for member firms.

Chairman Casey's letter of March 9th also referred to the possibility of future Commission requests for further reduction in the breakpoint level and as such indicated that the Exchange should at this time make any rule changes necessary to enable it to comply promptly with such requests.

It is presently possible for the Board and the membership to amend the Constitution and rules within a month's time. The Exchange's procedures with respect to Constitutional amendments do not call for the 2-week tabling period applicable at the New York Stock Exchange. Further, member organizations require time in cases of rate changes for the computer programming necessary to implement the changes. For these reasons, it is believed that changes in procedure would not be appropriate for this Exchange.

The proposed Constitutional amendments and amendments to Rule 398 are attached. If you have any questions concerning this matter, please do not hesitate to call me.

Very truly yours,

JJQ'N/dm
Enclosures

P.S.—In order to expedite matters, the above letter was read over the telephone to your secretary today.

AFFIDAVIT OF ROBERT M. BISHOP IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND EXHIBITS ANNEXED

(SAME TITLE)

STATE OF NEW YORK)
ss.:
COUNTY OF NEW YORK)

ROBERT M. BISHOP, being duly sworn deposes and says:

1. I am the Director of the Department of Member Firms and Vice President of the defendnat New York Stock Exchange, Inc. (the "NYSE"), reside at 4 Kimball Circle, Westfield, New Jersey 07090, and have my business office at 4 New York Plaza, New York, New York 10005. I make this affidavit upon personal knowledge, my examination of the records of the NYSE and in support of defendants' motion for summary judgment.

2. The NYSE was founded in 1792 and is now a corporation organized under the laws of the State of New York. Since its inception, the NYSE's principal activity has been and continues to be to provide for its members and the investing public a two-way auction market in securities listed on the NYSE. (A two-way auction market is one in which there is competition not only between buyers and sellers but also among sellers and buyers). At present, there are 1366 members of the NYSE (membership is only available to individuals) and 527 member organizations (partnerships and corporations in which at least one general partner or director, owning voting stock, is an NYSE member).

3. Since its founding, the NYSE has had and still has rules limiting access to NYSE facilities and rules prescribing the minimum rates of commission to be charged on transactions in securities listed on the NYSE,

although the level and structure of these rates has been changed from time to time. Violation of the NYSE's rules with respect to minimum commissions which must be charged to non-members has at all times been punishable by disciplinary action against members and member organizations.

4. Following the enactment of the Securities Exchange Act of 1934 (the "Exchange Act"), the NYSE on September 11, 1934 submitted to the Securities and Exchange Commission (the "SEC") an application for registration as a national securities exchange, together with copies of its then Constitution and Rules which included provisions requiring members to charge specified minimum commissions. A copy of the Constitution and Rules relating to commissions submitted in 1934 is annexed hereto as Exhibit 1.

5. The SEC approved the NYSE's application by an order dated September 28, 1934 (copy annexed as Exhibit 2) making registration effective on October 1, 1934, in which the Commission expressly stated its finding that the Constitution and Rules of the NYSE "are just and adequate to insure fair dealing and to protect investors" and provided "for the expulsion, suspension or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade."

6. Since such registration on October 1, 1934, the provisions of the Constitution prescribing minimum rates of commission have been changed by the ten times, effective on the following dates: January 3, 1938; March 18, 1942; November 3, 1947; November 9, 1953; May 1, 1958; December 5, 1968; April 5, 1970; April 5, 1971; March 24, 1972; and, April 24, 1972. Each such change was recommended, and made, on the basis of factual studies and/or formal reports prepared by the NYSE or the SEC. Indeed, the commission rate structure which is presently in effect is the product of studies by the NYSE

extending over more than a decade, two major studies conducted by the SEC [*Report of the Special Study of Securities Markets*, House Doc. No. 95, 88th Cong., 1st Sess. (1963) and *The Institutional Investor Study*, House Doc. No. 92-64, 92nd Cong., 1st Sess. (1971)] and public hearings conducted by the SEC extending over a period of more than three years.

7. In each case of a rule change, the NYSE forthwith furnished copies of the rule change to the SEC as required pursuant to Section 6(a)(4) of the Exchange Act and SEC Rule 17a-8.

8. At the time of the proposed change in commission rates in 1958, the SEC ordered an inquiry as to whether such changes "appear to be reasonable and in accordance with the standards contemplated by the applicable provisions of the Securities Exchange Act of 1934". (SEC Release announcing study annexed as Exhibit 3). The NYSE aided the SEC in making this study by submitting a substantial volume of detailed data and statistical information in connection with the finances, income, expenses and profits of member organizations.

9. After the completion of that study, by letter of January 28, 1959 (Exhibit 4), the SEC requested by NYSE to make certain changes in its 1958 rate schedule; and, following a series of meetings between the NYSE and SEC staff, the NYSE complied with the SEC's requests. The completion of the study was publicly announced in a release dated February 20, 1959 (Exhibit 5), which expressly stated that the aforementioned study was made in accordance with the provisions imposed upon the Commission by §19(b) of the Securities Exchange Act of 1934 with respect to the rules relating to "fixing of commission rates", and noted that "after extensive discussions the Exchange is taking steps in line with the suggestions of the Commission."

10. Even after the SEC had completed its study and had had its findings implemented, however, monitoring and

study of the commission rates continued. The NYSE had then a Special Committee on Member Firms Costs and Revenues (the "C&R Committee") whose delegated function from the Board of Governors was to review and study, on a continuing basis, the need for revisions and modifications of the commission rate structure to ensure that the NYSE fulfilled its federally mandated duty of self-regulation and its specific statutorily-imposed responsibilities with respect to the fixing of reasonable rates of commission.

11. The recent history of the revisions of the NYSE commission rate structure is of particular interest, not only because the particular changes made are specifically challenged in this action, but also because those changes were the product of the most extensive and meticulous analysis that the SEC had ever made of the issues.

12. After implementing the modifications of the commission rate transmitted by the SEC to the NYSE in 1959, the SEC requested that the NYSE undertake a study as to the need and feasibility of implementing a volume discount. This project was assigned to the C&R Committee, which commenced its study in late 1962.

13. After a review of an extensive amount of income and expense data relating to member organizations' securities commission business, the Committee was able to make the preliminary determination that, because commission rate structure failed to provide any discounts for block trades (*i.e.*, the commission on a 10,000-share lot was 100 times the commission on a 100-share lot), there existed the possibility that large traders would seek to execute orders off the exchanges at commission rates more reflective of economies of scale and thus fragment the central market. The C&R Committee concluded that this potential could become a real threat to the liquidity, depth and continuity of the central securities auction market because of the growing volume of institutional-sized business. Fur-

thermore, the preliminary investigation of the C&R Committee revealed the existence of numerous ingenious reciprocal and rebative practices devised by block traders and their agents to circumvent the commission rates, such as customer directed "give-ups." Recognition of the possible existence of these problems investigated by the Committee had been expressed in the SEC's *Report of the Special Study of Securities Markets*, House Doc. No. 95, pt. 2, pp. 347-*et seq.*, 88th Cong., 1st Sess. (1963). The Committee's initial conclusions substantiated the SEC's stated concern.

14. In late 1965, the C&R Committee reported its preliminary findings in connection with the need for a volume discount to the NYSE Board of Governors. In turn, the Board of Governors, through the then president of the NYSE, G. Keith Funston, relayed the C&R Committee's recommendations to the SEC by letter dated November 29, 1965.

15. SEC Chairman Manuel F. Cohen, writing for the Commission, replied on December 22, 1965 stating:

> "We agree . . . that a volume discount is necessary and appropriate and [understand] that the steps are being taken [by the Exchange] to devise a workable arrangement." (Exhibit 6)

16. In light of the SEC's indication of approval of a modification of the commission rate structure, the C&R Committee broadened the scope of its study of the volume discount question with an eye toward developing a specific proposal which would alleviate, if not eliminate, the problems of give-ups, reciprocal practices and market fragmentation. The SEC staff was kept periodically advised of the C&R Committee's efforts and, on January 2, 1968, the outline of a proposal was submitted to the SEC (Exhibit 7). The Commission made no specific response.

17. However, on January 26, 1968, the SEC proposed its own rule for adoption by national securities exchanges,

Rule 10b-10, specifically designed to deal with one aspect of the volume discount problem—give-ups. The substance of the SEC proposal was set forth in SEC Securities Exchange Act of 1934 Release ("SEC Release") No. 8239. Proposed Rule 10b-10 basically prohibited give-ups. In conjunction with this announcement the Commission also made public the NYSE proposal and invited all interested persons to submit written comments with respect to the two proposals on or before March 1, 1968. (SEC Release No. 8239 is annexed hereto as Exhibit 8).

18. On May 28, 1968, the SEC wrote to the NYSE stating its belief, based upn the Commission's extensive and continuing study of the commission rate structure of national securities exchanges, that "changes in the present commission rate structure are required to benefit the investing public," and announced its intention to hold public hearings pursuant to its authority under Section 21(a) of the Exchange Act on the rate structure issue commencing July 1, 1968 (Exhibit 9).

19. That same letter of May 28, 1968 also embodied a request, made pursuant to the Commission's Section 19(b) authority to review and revise NYSE rules fixing reasonable rates of commission, that the NYSE implement, on or before September 15, 1968, rules in respect of the commission rates contained in Article XV of the NYSE Constitution consistent with either (a) an SEC-revised commission schedule (attached to the May 28, 1968 letter) or (b) the elimination of minimum commissions on all orders in excess of $50,000 including reduction or elimination of the intra-member rate for non-executing member firms.

20. The SEC also emphasized in its letter of May 28, 1968 that the Commission's directive was purely an interim step made "in the context of [its] responsibilities to consider the national policies embodied both in the securities laws and in the antitrust laws." The matters discussed in

the May 28, 1968 letter were simultaneously made public by SEC Release No. 8324 (Exhibit 10).

21. Contemporaneously with the transmittal of the SEC's letter of May 28, 1968, and the issuance of SEC Release No. 8324, the Commission promulgated an order directing a public investigation of the commission rate structure of national securities exchanges and designating hearing officers. (Said order is annexed hereto as Exhibit 11).

22. During the period prior to the commencement of the public hearings scheduled for July 1, 1968, the SEC staff and the NYSE were in continual communication, and data relating to the interim revisions of the NYSE's minimum commission schedule were reviewed. (See Exhibits 12 and 13).

23. On June 27, 1968, the NYSE Board of Governors approved three basic elements of a new commission rate structure—1) a volume discount; 2) access for non-member broker-dealers; and 3; prohibition of customer-directed give-ups. (See Exhibit 14, Special Membership Bulletin of June 27, 1968).

24. On August 8, 1968, the then president of the NYSE, Robert W. Haack, wrote on behalf of the NYSE, replying to the SEC's interim directive stated in the Commission's letter of May 28, 1968 (Exhibit 9). In that letter, Haack submitted for the SEC's consideration the three part proposal approved by the Board of Governors on June 27, 1968, as a means of complying with the Commission's request for interim changes. A part of the proposaw was the NYSE's suggestion that the SEC's initialy recommended form of a volume discount be modified so as to embrace all public orders of more than 1,000 shares of stock. (Letter of August 8, 1968 annexed hereto as Exhibit 15).

25. On August 20, 1968, the NYSE wrote a further letter to the SEC amplifying the discussion in the August 8, 1968

letter [Exhibit 15]. On August 30, 1968, SEC Chairman Manuel Cohen replied to these two letters by modifying the Commission directive of May 28, 1968, to the NYSE proposal with the implicit condition that, if the membership failed to adopt the revised schedule, the SEC's alternative directive for the elimination of minimum commissions on orders in excess of a certain size might be directed to be implemented. (Exhibit 16)

26. By SEC Release No. 8399, dated September 4, 1968, the SEC further modified its May 28, 1968, directive by extending the mandated effective date for the interim changes of the schedule from September 15, 1968, to December 5, 1968. On December 5, 1968, the NYSE's interim revision including, *inter alia,* a volume discount in the commission rates to be charged on public orders involving more than 1,000 shares of stock, became effective.

27. During the period 1968 to 1970, the securities industry experienced a tremendous growth in the volume of public transactions. Member organizations of the NYSE were forced to make drastic and costly expansions to respond to this peak demand. Despite efforts to cope with the swell in public trading, the NYSE membership found its facilities overburdened and its resources strained. The volume discount enacted in December, 1968, threatened to exert further financial pressures because its predictable effect on commission income would be to diminish revenues. Moreover, despite increasing costs, there had been no increase in commission levels in nearly a decade. The result was that a large percentage of the brokerage firms were unable to operate profitably, particularly those member firms handling principally small orders; and the prognosis was for an exacerbation of this condition.

28. Thus, on February 13, 1970, the NYSE formally presented to the SEC a request for interim relief (to be implemented pending conclusion of the rate hearings, commenced on July 1, 1968 and then still in progress)

based upon statistical evidence documenting the financial distress of the industry. (Exhibit 17).

29. On March 16, 1970, the NYSE supplemented its presentation of the need of the industry for a commission increase. On March 19, 1970, the NYSE submitted to the SEC its proposal for the necessary relief in the form of a rule providing for the imposition of an interim service charge, in addition to the minimum commission chargeable, on all public transactions in securities listed on the NYSE involving 1,000 shares of stock or less. (Exhibit 18).

30. The SEC replied, by letter of April 2, 1970, stating that the Commission's data confirmed the need for the relief demanded and noting that the financial difficulties prevailing in the industry had "influenced many firms to impose limitations on their service to small investors". Therefore, the SEC continued, it would accept the imposition of the service charge (subject to Commission monitoring), provided that its effective term be limited to 90 days and the NYSE take all necessary steps to ensure that full brokerage services be restored for small investors. (Exhibit 19) The interim service charge became effective on April 6, 1970 and was expected to expire on July 6, 1970.

31. Prior to the anticiapted expiration date, however, the ongoing study of NYSE member firm financial data by the C&R Committee revealed the necessity of an extension of the interim service charge. Thus, on June 18, 1970, President Haack wrote SEC Chairman Hamer Budge relaying the C&R Committee findings and indicating that in light of the length of time which would pass before the promulgation and acceptance of a new commission rate structure, an extension of the interim service charge for at least an additional 90 days, commencing July 5, 1970, was necessary.

32. On June 29, 1970, the NYSE supplemented its proposal for an extension by supplying the SEC with additional statistical material justifying the extension of the service charge.

33. In SEC Release No. 8923 of July 2, 1970, the SEC announced that the Rate Structure Hearings (then still in progress) would be reconvened on July 13, 1970, for the purpose of receiving evidence on the necessity of extending the service charge. The SEC stated that it would not take action to terminate the service charge pending its determination of the necessity of its extension but conditioned its non-objection upon the same terms and conditions imposed on initiation of the charge. In addition, the Commission expressly conditioned the continuation of the surcharge upon the NYSE's agreement that it would not require the SEC to proceed under Section 19(b) of the 1934 Act if the Commission should determine that the interim service charge should be terminated. (Exhibit 20).

34. Hearings were conducted by the SEC on the extension of the service charge during the week of July 13 through July 17, 1970. In addition to the NYSE, testimony was received from the Association of Stock Exchange Firms; Patteson Branch of Branch & Co. (an NYSE member firm); Hans Randolph Reinisch and Evelyn Y. Davis (private investors); The Association of Investment Brokers; the National Association of Investment Clubs; Sam Sturniel (registered representative); National Investor Relations Institute; and the American Association of Securities Representatives. A number of letters were also received in response to the SEC's invitation for public comment on the service charge proposal.

35. In preparation for these hearings and pursuant to the SEC's mandate to the NYSE to gauge the impact of the interim service charge, the NYSE instituted a monitoring program which collated data as to the financial condition of the industry and inquired into 1) what efforts were being made to reduce costs; 2) whether size restrictions on orders were eliminated; and, 3) whether steps were being taken to limit withdrawal of capital.

36. The SEC continued to monitor and assess the results of the NYSE's program of study as to the need and impact of the interim service charge. SEC approval was not at any time revoked, but the interim service charge was repealed when the present commission rate structure was made effective on March 24, 1972.

37. On June 30, 1970, the NYSE proposed to the SEC a permanent commission rate schedule, or "rate package", to replace the interim reforms then in effect. Public hearings were held by the SEC on its "reasonableness" under the mandate of Sections 19(b) and 21(a) of the Exchange Act. (Exchange Act Release No. 9007 dated Oct. 22, 1970 annexed hereto as Exhibit 21).

38. On October 22, 1970, Chairman Budge of the SEC wrote to the NYSE informing it that "fixed charges for portions of orders in excess of $100,000 are neither necessary nor appropriate". (Exhibit 22). Then, on February 10, 1971, the SEC announced that "the Exchange should take immediate action to implement, by April 1, 1971, the Commission's finding that fixed minimum commissions on institutional-sized orders were neither necessary nor appropriate". The SEC, however, indicated that, in lieu of the proposed $100,000 "breakpoint" for negotiated rates, it would accept $500,000. (Exhibit 23).

39. The NYSE responded on March 9, 1971, that the proposed April 1 deadline did not allow sufficient time to review the SEC's negotiated rate proposal and implementations of a constitutional amendment. The SEC reiterated its directive to implement the negotiated rates at a $500,000 breakpoint and admonished the NYSE that the maintenance of minimum commission rates on portions of orders above $500,000 after the April 1 deadline "would be unreasonable and could be contrary to the Exchange Act." (Exhibit 24).

40. Despite reservations on the part of the NYSE that the

accelerated procedure for implementing the new rate proposal urged by the SEC was not in accord with Section 19(b) of the Exchange Act, the NYSE moved as expeditiously as possible to comply and adopted the necessary constitutional changes on April 5, 1971.

41. It was stressed by the Commission that the new rules and the $500,000 breakpoint did not represent a final determination and that the rules were "experimental". The SEC indicated that both the Commission and the NYSE would monitor the impact of the changes and that revisions could be expected.

42. Pursuant to the SEC's directive on monitoring, the NYSE, simultaneously with the enactment of the rules regarding negotiated commission rates on that part of orders in excess of $500,000, adopted Rule 384, which required each member to report detailed information on all orders exceeding $500,000.

43. The NYSE transmitted its monitoring information on the impact of negotiated commissions in the form of quarterly reports. Based upon these data and the Commission's own studies, the SEC concluded in its February 2, 1972 "Statement of the Future Structure of the Securities Markets", that the breakpoint between fixed and negotiated commissions should be lowered from $500,000 to $300,000 in April, 1972, and noted that if the Exchange failed to take the required action within 90 days, the Commission would move to implement the reduction. (Exhibit 25).

44. The SEC reiterated its conclusion, announced February 2, 1972, in a letter, dated March 9, 1972, from SEC Chairman William J. Casey to the NYSE, in which it was also indicated that further reductions in the breakpoint were being contemplated.

45. On March 16, 1972, the NYSE Board of Governors approved in principle the amendments to the Constitution

which would reduce the breakpoint to $300,000 in compliance with the directive of the SEC. On March 17, 1972, the proposed amendments were submitted to the SEC. (Exhibit 26).

46. The NYSE then wrote the SEC on March 23, 1972, setting forth the timetable the Board of Governors intended to follow in implementing the breakpoint reduction: final action by the Board on March 30, 1972; submission to the membership on April 12, 1972; and, assuming affirmative action, an effective date of April 24, 1972. The NYSE also indicated it would continue the monitoring of the impact of negotiated commission rates as directed by the SEC. (Exhibit 27).

47. During the course of this review, study and interim revision of the 1958 commission rate structure, the SEC was engaged in a series of public hearings which commenced on July 1, 1968 and were terminated in 1971. These hearings and the other regulatory activity during that period with respect to commissions (described above) resulted in the proposal by the NYSE and approval by the SEC of the present commission rate structure, effective March 24, 1972, which repealed the previously adopted volume discount and the interim service charge and replaced it with a schedule of commission rates incorporating a cost-related discount for volume transactions and negotiated rates of commission on that portion of orders in excess of $300,000. The present commission rates, however, may not reflect a final resolution by the SEC of the commission rate structure. Indeed, both the NYSE and the SEC intend to review, on a continuing basis, the propriety and feasibility of reducing the breakpoint between minimum and negotiated rates after a sufficient period has elapsed under the present rules.

s/Robert M. Bishop
Robert M. Bishop

Sworn to
December 4th, 1972

CONSTITUTION

C-53

ARTICLE XIX.

Commissions.

Obligation to charge and collect.

*Sec. 1. Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for account of others, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a Rule adopted by the Governing Committee, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member of the Exchange or firm registered thereon.

No rebatement or allowance for business procured

†Sec. 2. Commissions shall be as follows:

To non-members. Joint accounts and non-member partners.

(a) *On business for parties not members of the Exchange, including joint account transactions in which a non-member is interested; and on transactions for partners not members of the Exchange:*

Stocks.

††On Stocks:
(except as to Ten-share-unit
Stocks, as stated below)

*As amended May 13, 1926.
†Effective June 10, 1926.
††See also Paragraph (c) on Page C-56.

PRICE	RATE PER SHARE
Selling under 50¢	As mutually agreed
Selling at 50¢ and above but under $1	Not less than 3¢
Selling at $1 and above but under 10	Not less than 7½¢
Selling at $10 and above but under $25	Not less than 12½¢
Selling at $25 and above but under $50	Not less than 15¢
Selling at $50 and above but under $75	Not less than 17½¢
Selling at $75 and above but under $100	Not less than 20¢
Selling at $100 and above but under $200	Not less than 25¢
Selling at $200 and above but under $250	Not less than 30¢
For each additional $50 in price	5¢ additional

$1.00 minimum. provided, however, that on every transaction which involves an amount of $15 or more, the minimum commission shall be not less than $1.00.

Ten-share unit stocks. *†On Ten-Share-Unit Stocks:
(as designated by the Committee of Arrangements)

PRICE	RATE PER SHARE
Selling at less than $1 per share	As mutually agreed
Selling at $1 per share and above but under $5	Not less than 5¢
Selling at $5 per share and above but under $10	Not less than 10¢
Selling at $10 per share and above but under $100	Not less than 20¢
Selling at $100 per share and above	The same rates as provided for other stocks.

Bonds. **†On Bonds:

PRICE PER $1,000 OF PRINCIPAL	RATE PER $1,000 OF PRINCIPAL
Selling at less than $10	Not less than 75¢
Selling at $10 and above, but under $100	Not less than $1.25
Selling at $100 and above	Not less than $2.50

Rights. On Subscription Rights

PRICE	RATE PER RIGHT
Selling under 50¢	As mutually agreed
Selling at 50¢ and above, but under $1	Not less than 5¢
Selling at $5 and above, but under $10	Not less than 7½¢
Selling at $10 and above	Not less than 15¢

*Effective June 10, 1926. As amended January 7, 1931.
†See also Paragraph (d) on page C-56.
**As amended October 29, 1925, January 17, 1930, June 29, 1932, and May 11, 1933.

(b) On business for members of the Exchange when a principal is not given up: To members.

†On Stocks: Stocks cleared.

(except as to Ten-share-unit Stocks as stated below)

PRICE	RATE PER SHARE
Selling under 50¢	As mutually agreed
Selling at 50¢ and above but under $1	Not less than 3/4¢
Selling at $1 and above but under $10	Not less than 1-3/4¢
Selling at $10 and above but under $125	Not less than 3-3/4¢
Selling at $125 and above	Not less than 5¢

*†On Ten-Share-Unit Stocks: Ten-share unit stocks cleared

(as designated by the Committee of Arrangements)

PRICE	RATE PER SHARE
Selling at less than $1 per share	As mutually agreed
Selling at $1 per share and above but under $5	Not less than 2¢
Selling at $5 per share and above but under $10	Not less than 4¢
Selling at $10 per share and above	Not less than 8¢

**†On Bonds: Bonds cleared.

PRICE PER $1,000 OF PRINCIPAL	RATE PER $1,000 OF PRINCIPAL
Selling at less than $10	Not less than 50¢
Selling at $10 and above but under $100	Not less than 62½¢
Selling at $100 and above	Not less than $1.25

On Subscription Rights: Rights cleared.

PRICE	RATE PER RIGHT
Selling under 50¢	As mutually agreed
Selling at 50¢ and above but under $1	Not less than 3/4¢
Selling at $1 and above but under $5	Not less than 1-1/4¢
Selling at $5 and above but under $10	Not less than 1-3/4¢
Selling at $10 and above	Not less than 3-3/4¢

*Effective June 10, 1926. As amended January 7, 1931.
†See also Paragraph (d) on page C-56.
**As amended October 29, 1925, January 17, 1930, June 29, 1932, and May 11, 1933.

(c) *On business for members of the Exchange when a principal is given up:* To members.

†On Stocks:

Stocks not cleared.

(except as to Ten-share-unit Stocks, as stated below)

PRICE	RATE PER SHARE
Selling under 50¢	As mutually agreed
Selling at 50¢ and above but under $1	Not less than /¢
Selling at $1 and above but under $10	Not less than 1-1/4¢
Selling at $10 and above but under $125	Not less than 2½¢
Selling at $125 and above	Not less than 3¢?

Except that when the amount dealt in is less than 100 shares of stock the commission shall be not less than 1¢ per share on stocks selling below $10 per share and 2¢ per share on stocks selling at $10 per share and over.

Odd lots of stock not cleared.

*†On Ten-Share-Unit Stocks:

Ten-share-unit stocks not cleared.

(as designated by the Committee of Arrangements)

PRICE	RATE PER SHARE
Selling at less than $1 per share	As mutually agreed
Selling at $1 per share and above but under $5	Not less than 1¢
Selling at $5 per share and above but under $10	Not less than 2¢
Selling at $10 per share and above	Not less than 4¢

**†On Bonds:

Bonds not cleared.

PRICE PER $1,000 OF PRINCIPAL	RATE PER $1,000 OF PRINCIPAL
Selling at less than $10	Not less than 25¢
Selling at $10 and above but under $100	Not less than 37½¢
Selling at $100 and above	Not less than 75¢

*As amended June 10, 1926 and January 7, 1931.
†See also Paragraph (d).
**As amended October 29, 1925, June 23, 1928, January 17, 1930, June 29, 1932, and May 11, 1933.
††As amended December 16, 1926.
§See Note 1, on page C-131.

On Subscription Rights:

Rights not cleared

PRICE	RATE PER RIGHT
Selling under 50¢	As mutually agreed
Selling at 50¢ and above but under $1	Not less than /¢
Selling at $1 and above but under $5	Not less than 3/4¢
Selling at $5 and above but under $10	Not less than 1-1/4¢
Selling at $10 and above	Not less than 2-1/2¢

Exceptions to above rates.

††(d) *On Obligations of the United States, Purto Rico, Phillippine Islands, and States, Territories and Municipalities therein; Bonds or, Notes having five years or less to run; Securities which, pursuant to call or otherwise, are to be redeemed within twelve months:*

Such rates to members or non-members as may be mutually agreed upon; provided, however, that the Committee on Quotations and Commissions may determine special rates on any or all of the above-mentioned securities, reporting the same to the Governing Committee.§

Original issues.

Sec. 3. If a member of the Exchange, or firm registered thereon engaged in transactions in which the member or firm is acting as a dealer in securities of original issue, the rates of commission prescribed in this Article shall not apply to such transactions if not made on the Exchange; provided, however, that such transactions shall be subject to such regulations as the Committee on Quotations and Commissions may from time to time prescribe.

Proposed violation.

Sec. 4. No member shall make a proposition for the transaction of business at less than the minimum rates of commission prescribed in this Article.

CHAPTER VII.

Commissions.

Clearance on orders from a non-member.

Sec. 1. In transactions where orders are received from a non-member, and the broker filling the order is directed to give up another broker or clearing firm, the responsibility for collecting the full commission specified in Section 2, Article XIX of the Constitution shall rest with the broker or clearing firm settling the transaction.

Clearances on orders from a member.

Sec. 2. In transactions where orders are received from a member, and a clearing firm is given up by said member or by his order, the responsibility of collecting the full commission specified in Section 2, Article XIX of the Constitution shall rest with said clearing firm; and it shall be the duty of the broker who executes such orders to report the transactions to the clearing firm and render his bill to them therefor at the rates specified; a broker who executes an order for a member and clears the security himself must charge the rates specified in said Section.

Transactions made outside of United States or Canada.

Sec. 3. When a non-member shall cause to be executed in a market not in the United States or Canada an order for the purchase or sale or securities listed on this Exchange, and said purchase or sale shall be accepted by a member of this Exchange, or firm registered thereon, for the account of said non-member, the commission specified in Section 2, Article XIX of the Constitution shall be charged the non-member in addition to any commission charged by the party or parties making the transaction.

Deliveries on privileges.

Sec. 4. When securities are received or delivered for a non-member, on a privilege, the commission

*As amended November 23, 1927.

specified in paragraph (*a*) of Section 2, Article XIX of the Constitution must be charged.

Clearances for members.

Sec. 5. When a member receives and delivers securities for another member, the clearing charge for said service may be a matter of mutual agreement, said charges to be based upon a stipulated sum of money for each one hundred shares of stock or one thousand dollars of bonds; the payment of a certain sum of money for any period of time for said service, irrespective of the number of shares or amount of bonds cleared, is forbidden.

Business at nominal or no commission.

Sec. 6. No member shall without commission or for a nominal commission, transact or offer to transact for any customer who is dealing in securities dealt in on the Exchange, any business in cotton, grain, produce or other commodities.

Reciprocal business in commodities.

Sec. 7. No member shall agree to give reciprocal business in cotton, grain, produce or other commodities, dependent upon the amount of business received by him in securities dealt in on the Exchange.

Bunched orders.

Sec. 8. The execution of "bunched" orders, without the charging of the required commission, is forbidden.

Sec. 9. Any agreement or arrangement between a member and his customer, whereby special and unusual rates of interest are given or money advanced upon unusual terms, with intent to give special or unusual advantage to such customer, for the purpose of securing his business, is forbidden.

Unusual interest rates or money advances.

Transactions in securities dealt in on the New York Stock Exchange being based on delivery and settlemznt in New York City all payments with respect thereto must be made accmrdingly.

If settlements with customers in the case of sales by them are made at any time prior to the actual date of settlement in New York or at any time subsequent

thereto in the case of purcmases, interest, at not less than the approximate ruling rates for money, for the full times involved must be deducted or added as the case may be.

*In transactions where the amount of interest is less than $1.00, the collection of the interest involved may be waived at the discretion of the member. Any abuse of this privilege may be held to be an act detrimental to the interest and welfare of the Exchange. Interest on out of town transactions.

Sec. 10. An alloweance for interest on short sales of stock shall not be more than the loan market rates for the stocks borrowed or used for such short sales. Short sales.

†11. No member shall make any transaction in a listed security "over the counter", for his own account, or the account of his firm, or for that of a partner, or for any account in which either he or they have a direct or indirect interest, and a reverse operation upon the Exchange at or about the same time, wherein the difference between the purchase and sale prices is less than the recognized commission on such a purchase or sale. "Over the counter" transactions.

Sec. 12. No member shall, directly or indirectly, by agreement or otherwise, assume or bear for his own account or relieve his principal from any part of any stamp tax imposed by the United States or by any State on transfers or sales of securities. Transfer rates.

*Sec. 13. No member shall assume for his own account or for the account of his firm, a contract made for a customer after a loss to the customer has been established or ascertained unless the contract was made by mistake or unless the consent of the Committee on Quotations and Commissions has first been obtained. Assuming contract.

†Sec. 14. Unless otherwise agreed by the parties concerned, all payments between members of the Method of payment of Floor Commissions.

Exchange on account of commissions on business when a principal is given up shall be made through Stock Clearing Corporation as provided in its By-Laws and Rules.

*Amended May 25, 1927.
†See Note 8 on page C-132.

*Adopted October 26, 1927.
†Adopted September 14, 1932—effective October 1, 1932.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

September 28, 1934

New York Stock Exchange
New York, N.Y.

Gentlemen:

Enclosed you will find a copy of an order of the Commission registering the New York Stock Exchange as a national securities exchange.

Very truly yours,
JOHN J. BURNS
General Counsel

THE SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

The NEW YORK STOCK EXCHANGE having applied to the Commission for registration as a national securities exchange, pursuant to Section 6 of Title I of the Securities Exchange Act of 1934, and it appearing to the Commission upon such examination as, under the limitations of time, the Commission has had opportunity to make of the evidence now before it, that said exchange is so organized as to be able to comply with the provisions of said title and the rules and regulations thereunder and that the rules of said exchange are just and adequate to insure fair dealing and to protect investors, as indicated in Section 6(d) of said Title, and it further appearing that the above exchange has agreed in accordance with Section 6(a) (1) to comply and to enforce so far as is within its powers, compliance by its members with provisions of the Act and any amendments thereto and any rule or regulation made or to be made

thereunder, and it further appearing that the said exchange by its rules provides for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declares that the wilful violation of any provisions of the Act, of any rule or regulation thereunder shall be considered conduct inconsistent with just and equitable principles of trade, and, under Section 19 and other sections of said Act, the Commission having powers to alter or supplement the rules of exchanges, it is hereby

ORDERED that said exchange be and hereby is registered as a national securities exchange, such registration to be effective October 1, 1934.

If it appears at any time to the Commission, either upon a hearing on such question at which any interested party may appear, or otherwise, that said exchange in any respect is not so organized as to be able to comply with said title and said rules and regulations, or that the rules of said exchange in any respect are not just and adequate to insure fair dealing and to protect investors this registration shall in no wise preclude the Commission from so finding and revoking this registration or taking such other action as it deems appropriate pursuant to Section 19 or any other appropriate provision of said title.

SECURITIES AND EXCHANGE COMMISSION
BY F.P. Brasser
Secretary

Date — Sept. 28, 1934.

For IMMEDIATE Release Monday, April 14, 1958

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

Securities Exchange Act of 1934
Release No. 5678

The Securities and Exchange Commission has announced that it has directed its staff to conduct a study of the commission rates to be charged by members and member firms of the New York Stock Exchange under a recent amendment of its constitution to be effective May 1, 1958, and to report to the Commission whether such commission rates and other charges appear to be reasonable and in accordance with the standards contemplated by applicable provisions of the Securities Exchange Act of 1934.

Section 19(b) of the Securities Exchange Act of 1934 imposes on the Commission certain responsibilities and duties with respect to the rules of national securities exchanges, including rules in respect of such matters as the fixing of reasonable rates of commission and other charges.

Chairman Edward N. Gadsby made the following comment with respect to the Commission's study:

> "Our study of the Exchange's commission rates should not be taken as an indication that the Commission believes the Exchange's recently-adopted increase in commission rates may be improper or unjustified. A determination as to whether or not the Exchange's commission rates are reasonable can only be made upon the basis of a thorough review and analysis of all pertinent facts. To aid the Commission in its consideration of this question, we have instructed our Staff to conduct a study for the purpose of developing the factual data upon which a fair appraisal may be made of the Exchange's rate structure."

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON 25, D.C.

January 28, 1959

Mr. Edward C. Gray
Executive Vice President
New York Stock Exchange
11 Wall Street
New York 5, N.Y.

Dear Mr. Gray:

In accordance with our discussions on January 27, 1959, attached herewith is a release which would be issued by the Commission in substantially this form if the Board of Governors of the Exchange should approve the staff proposals relating to commission rates. You will note that a percentage figure is omitted from the second sentence of the next to the last paragraph of the release. The precise percentage figure would depend upon the commission rate schedule approved by the Board of Governors.

In order to insure that there is complete understanding as to the proposals which are being considered by the Special Committee on Member Firm Costs and Revenues I think it important to specifically enumerate them:

1. A proposed Exchange rules substantially in the form of the Exchange draft dated December 31, 1958. I understand that at the suggestion of the staff of the Commission the Special Committee will give consideration to amending that rule to provide that, in addition to proposed amendments to Article XV of the Exchange Constitution relating to rates of commission, the rule would cover proposed rules under Section 9 of Article XV relating to service charges.

2. A proposed letter from Keith Funston, President of the Exchange, to Philip A. Loomis, Jr., Director of the Division of Trading and Exchanges, substantially in the

form of the draft letter submitted to you on January 27, 1959.

3. A proposed amendment to Article XV of the Exchange Constitution providing for a new commission rate schedule substantially along the lines of one of the SEC Suggested Schedules A, B or C presented to you on January 27, 1959. I understand that you will advise us of the precise schedule which is to be considered by the Special Committee as meeting the objections made by the staff.

4. A proposed amendment to Article XV providing for the elimination of the "round turn" commission rate on transactions.

5. An agreement to prepare an outline for a cost study in consultation with the staff of the Commission which study would be made by experts employed for that purpose by the Exchange.

6. A reexamination by the Special Committee on Member Firm Costs and Revenues of the use of the round lot as the basis for the rate structure.

7. An undertaking by the Exchange to consult with the staff of the Commission for the purpose of developing and refining the income and expense survey of member firms as a source of data in connection with commission rates.

If the Special Committee determines not to recommend the staff proposals to the Board of Governors, I would appreciate being advised as soon as possible. If both the Special Committee and the Board of Governors accept the staff proposals and the two amendments to the Exchange Constitution are submitted to the membership, I should point out that in the event that the Exchange membership does not approve the proposed changes in the rate schedule the position of the Commission and the action it might take would be substantially the same as if the staff proposals

had not been approved by the Board of Governors.

Very truly yours,
s/ Philip A. Loomis
Philip A. Loomis, Jr.
Director

Enclosure:
Release

DRAFT

For IMMEDIATE RELEASE

SECURITIES AND EXCHANGE COMMISSION
Washington 25, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No.

The Securities and Exchange Commission announced today that its staff had completed a study of commission rates charged by members of the New York Stock Exchange as a result of an increase in commission rates adopted by the Exchange on May 1, 1958.

The study, announced in Securities Exchange Act Release No. 5678, dated April 14, 1958, was made in view of the responsibilities and duties imposed upon the Commission by Section 19(b) of the Securities Exchange Act of 1934 with respect to the rules of national securities exchanges, including rules relating to the fixing of commission rates.

The conclusions reached by the staff were the subject of extensive discussions with the Exchange following which the Exchange is taking various steps conforming to the suggestions of the staff.

The steps to be taken fall into three general areas: first, the giving of greater advance notice to the Commission and to the public concerning proposed changes in commission rates and other charges; secondly, the initiation of certain studies by the Exchange in collaboration with the Commission in respect to the rate structure and the development and presentation of information concerning the costs incurred by member firms in the securities commission business; and thirdly, the making of certain reductions in commission rates for small value transactions together with the elimination of the so-called "round-turn" commission rate.

With respect to advance notice, the Exchange has amended its rules to provide a public announcement of any proposal to change commission rates or other charges 30 days in advance of action by the Board of Governors of the Exchange. The Exchange has also given assurances that it will keep the Commission advised of any steps taken by the Exchange looking towards such change.

An Exchange committee will reexamine the use of the round-lot as the basis for the rate structure as compared with the use of a schedule primarily based upon the amount of money involved in the transaction. The Exchange also proposes to study the possibility of improving its income and expense survey of member firms as a source of data in connection with commission rates and, in consultation with the staff of the Commission, to prepare an outline of a cost study which would be made by experts employed for that purpose by the Exchange.

With respect to commission rates themselves the Board of Governors of the Exchange has approved a proposed amendment to the commission rate schedule for submission to the membership which would reduce the commission rate on transactions ranging from $100 to $2,400. The proposed amendment would reduce commissions approximately percent on the average in this area. These modifications were suggested in view of the fact that the May 1958 commission rate increase on transactions between $100 and $2,400 was relatively greater than the increase upon larger transactions. The Board of Governors has also recommended to the membership the elimination of the so-called "round-turn" commission rate under which a reduced rate is granted to persons whose purchase and sale of the same security is completed within 14 days. It was the view of the staff that a special discount for this type of transaction was not justified and the Exchange felt that it had not achieved its desired objective.

The Exchange cooperated fully with the staff of the

Commission in the making of the study and in the subsequent discussions which the Commission believes have been and will be productive of results in keeping with the objectives of the statute.

For IMMEDIATE Release Friday, February 20, 1959

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

Securities Exchange Act of 1934
Release No. 5889

The Securities and Exchange Commission announced today that its staff had completed a study of commission rates charged by members of the New York Stock Exchange as a result of an increase in commission rates adopted by the Exchange on May 1, 1958.

The study, announced in Securities Exchange Act Release No. 5678, dated April 14, 1958, was made in view of the responsibilities and duties imposed upon the Commission by Section 19(b) of the Securities Exchange Act of 1934 with respect to the rules of national securities exchanges, including rules relating to the fixing of commission rates.

After extensive discussions the Exchange is taking steps in line with the suggestions of the Commission.

These steps fall into three general areas. Firstly, the making of certain reductions in commission rates on transactions under $2,400 together with the elimination of the so-called "round-turn" commission rate; secondly, the initiation of further studies by the Exchange in collaboration with the Commission in respect to the rate structure and the development of information concerning the costs incurred by the member firms in the securities commission business; and, thirdly, establishment of revised procedures to provide the Commission and the public with greater advance notice in cases where the Exchange's Board of Governors is to consider proposed changes in commission rates.

With respect to commission rates, the Board of

Governors of the Exchange has approved and submitted to the membership an amendment to the commission rate schedule which would reduce the commission rate on transactions ranging from $100 to $2,400. The change would reduce commissions approximately five per cent on the average in this area. These modifications were suggested in view of the fact that the May 1958 percentage increases on transactions from $100 to $2,400 were relatively greater than the average percentage increase. The Board of Governors has also recommended to the membership the elimination of the so-called "round-turn" commission rate under which a reduced rate is granted to persons whose purchase and sale of the same security is completed within 14 days. It was the view of the Commission that this type of transaction was not entitled to a special discount and the Exchange felt this rate had not achieved its desired objective.

An Exchange committee will further study the use of a so-called volume or block discount for transactions involving multiple round lot units. The Exchange also proposes to study the possibility of further developing its income and expense survey of member firms as a source of data in connection with the commission rates, and to work with the staff of the Commission and consultants employed by the Exchange to prepare an outline for the basis of a cost study to be made by the Exchange.

With respect to the advance notice, the Exchange proposes to amend its rules to provide that any proposed Constitutional amendment to change commission rates or other charges shall be announced 30 days in advance of action by the Board of Governors of the Exchange. Also, the Commission will be advised of any steps taken by the Exchange looking toward changes in commission rates or other charges.

SECURITIES AND EXCHANGE COMMISSION
Washington 25, D.C.

December 22, 1965

Mr. G. Keith Funston, President
New York Stock Exchange
11 Wall Street
New York, New York 10005

Dear Keith:

Thank you for your letter of November 29 concerning the Exchange commission rate structure and Rule 394. The Commission has given considerable thought to the views of your Committee on Costs and Revenues, as outlined in your letter of November 11, and to the views expressed at your presentation to the Commission on November 24. Furthermore, as you know, the staffs of the Commission and the Exchange have had fruitful discussions of both of these subjects which have been reported to the Commission.

The Commission would like to assist the Exchange and the securities industry in their attempts to revise the commission rate structure in the context of the findings of the Special Study Report and more recent developments in the securities industry. This letter is addressed to four specific matters: (1) the problems created by what you have referred to as "give-ups" and "give aways" of commissions; (2) access to the Exchange by certain non-members having customers orders for execution; (3) volume discounts; and (4) Rule 394.

In seeking to distinguish the "give-up" from the "give away", to use your terms, your Committee is attempting to meet a substantial problem affecting the securities industry today. We do not believe, however, that the solution suggested in your November 11 letter resolves this problem in a thoroughly adequate manner. It is clear from your letter and from subsequent discussions that under your

proposal members would continue to share in Exchange commissions as extra compensation for mutual fund sales although it might appear that technically they would provide services to the executing firm in originating or transmitting orders. In reality, however, any services that such firms would perform would seem to be unnecessary for the execution of the order and for the most part would create additional paperwork merely to justify a give-up.

Absent a countervailing showing, it would appear that sharing in commissions, in the sense of providing rewards that are unrelated to the execution of transactions for bona fide customers, is not an appropriate practice. Such arrangements should be distinguished from the situation in which a broker-dealer is selected by his customer to execute an order and from the performance by other broker-dealers of appropriate and valuable services in connection with the transaction. We think that it would be desirable to frame rules dealing with this matter in general terms and then to set forth specific criteria concerning the participation by other brokers in the execution and the commissions. These criteria could include, for example, whether the compensation received by each participating broker bears a reasonable relationship to the services actually performed by him; whether persons paying commissions to a broker are bona fide customers of such broker; whether a customer directs the method or manner of execution and sharing of the commissions and the size of the transactions.

In this connection, the best test of whether a give-up is actually compensation for services connected with a transaction, such as execution or clearance, may be whether the portion of the commission given up bears a reasonable relationship to the intra-member commission rates set out in the Exchange Constitution.

We are generally in accord with the Committee's view that certain nonmember broker-dealers who cause their customers orders to be brought to the floor through a

member should be entitled to compensation for their services in connection with the execution of the order by appropriate sharing of the commission. If, however, arrangements are made for such sharing of commissions, they should be so confined that they cannot be used as a vehicle for perpetuating or extending improper give-up practices and consequently the measures discussed above with respect to the splitting of commissions among members should be equally applicable to any sharing of commissions with nonmembers.

Assuming such broker-dealers would be considered "members" under Section 3(a)(3) of the Exchange Act, we think that the Exchange's regulatory role and responsibility for the securities activities of such firms can be satisfactorily resolved. In this connection, we think that the solution to this as well as to other problems of overlapping jurisdiction may be found in coordination of activities and responsibilities among the self-regulatory organizations and this Commission. As you know, the Commission has begun discussions with your Exchange and other agencies with a view to improving coordination of regulatory efforts. The question of the proper regulatory control of nonmember firms that may have access to your Exchange can be included in these discussions. After a determination has been made as to the specific arrangements for such sharing of commissions, the Commission would be disposed to adopt an appropriate rule which would provide the necessary protections with respect to Section 3(a)(3).

We agree with what we understand to be the view of the Committee that a volume discount is necessary and appropriate and that steps are being taken to devise a workable arrangement. We are fully aware of the mechanical problems inherent in the institution of a volume discount, particularly as it relates to the division of commissions on blocks, a portion of which may be executed by one or more different brokers or on one or more regional exchanges. We believe, however, that a satisfactory

solution can be found.

With regard to Rule 394, I am enclosing herewith the conclusions and recommendations arrived at by the staff of the Commissioner in their study of this subject. We understand that you have had a thorough discussion with our staff of the underlying materials which form the basis for such conclusions and recommendations. The Commission believes the recommendations of thie staff have considerable merit, and that they derive support from the record of the inquiry. We have carefully considered the Exchange's position as presented during our inquiry concerning this matter and at our meeting of November 24. We believe that it is incumbent on the Exchange to consider the approach suggested or offer alternative answers or solutions to meet and resolve the problems raised.

We recognize that the problems raised by the Exchange commission rate structure and Rule 394 are complex and far-reaching. We would expect to provide assistance to you in working out the details within the guidelines set forth and our staff is prepared to meet with you to discuss these matters. If you believe that any of the above suggestions or comments are inappropriate we, of course, would be pleased to receive any factual commentary which you believe would aid the Commission in its evaluation of these matters.

As you know, these matters have been considered by the Exchange and the Commission for many months and though we expect that their ultimate implementation may require our communication with other self-regulatory institutions and other affected parties, we hope that these matters can be moved forward to their resolution within a reasonably short period of time.

Sincerely,

s/Manuel F. Cohen
Manuel F. Cohen
Chairman

Enclosure

LETTER DATED JANUARY 2, 1968

NEW YORK STOCK EXCHANGE
ELEVEN WALL STREET
NEW YORK, N.Y. 10005

January 2, 1968

TO: Members and Allied Members

SUBJECT: *Commission Rate Structure Proposal*

A principal unsolved problem facing the securities industry is that involving the New York Stock Exchange commission rate structure. The complexities and ramifications are such that they are not generally understood even though they directly or indirectly affect the New York Stock Exchange and its members, regional exchanges and their members, the third market, non-member broker-dealers, institutional investors and, of course, the public.

The problem has become more acute by reason of certain pressures which are building up in Congress, government agencies and departments, a segment of the press and the SEC which has oversight responsibilities in the area. The issue is further complicated by the fact that the Exchange, enjoying the privilege of self-regulation and operating under a government approved commission rate structure and certain anti-trust immunities, has an obligation to review its fees and industry developments and practices in the light of public interest. This is a problem which cannot be solved by the Exchange alone. However, inaction on our part is apt to result in the problem being solved by those outside the industry who may be less familiar with the ramifications and as a result might direct changes less satisfactory than those we initiate.

The minimum commission rate is ceasing to be a "minimum" because of practices which have developed

and which are proliferating. This is the case in large measure because certain institutional investors are naturally desirous of achieving a lower commission rate on large transactions, and brokers who are non-members of this Exchange are understandably interested in achieving access to the commission dollar. To accomplish these objectives, among others, a wide range of devices is being employed. Membership on regional stock exchanges, used in both simple and complex reciprocal arrangements related to NYSE transactions, has resulted in a practical access to the New York Stock Exchange. Other practices have in effect given certain institutions commission discounts. One exchange, by permitting rebates to SECO members, in effect is giving a public and institutional discount. Through complicated arrangements there are now certain sophisticated individuals who manage to receive 40% rebates on their listed transactions. The net result, brief, is an intricate maze involving give-ups, give-aways, reciprocal practices, manufactured participations in trades, transported trades moved from one Exchange to another, all of which result in a leakage of the commission dollar.

The situation also reflects a commission structure which was most recently revised in 1959 and which does not properly recognize significant changes which have since taken place in the mix of our business. We are all aware of the increased institutional activity which is one of the significant phenomena of our time and which in all likelihood will continue to grow. It seems reasonable that institutional business with its unique characteristics and demands must be recognized in our commission changes. Moreover, failure to recognize and speak to the problem will inevitably result in a diversion of activity to competing marketplaces.

Because of all of the foregoing, the Board of Governors has unanimously adopted a resolution which had earlier

been recommended by the Cost and Revenue Committee and which has the further approval of the Regional Firms Advisory Committee and the Liaison Committee of the Association of Stock Exchange Firms to the effect that the New York Stock Exchange proposes to

(1) incorporate a volume discount in the minimum commission schedule, the amount and nature of such discount to be subsequently determined.

(2) support continuation of the practice of customer directed give-ups on their own transactions with a limitation on the percentage amount which may be so given-up.

(3) take steps to prohibit reciprocal practices which result in de facto rebates of NYSE commissions even where those arrangements involve other markets than the NYSE floor, provided that the SEC will aid in prohibiting such practices in other markets.

(4) allow a discount in the minimum commission schedule for non-member brokers, both domestic and foreign, with qualifications to be specifically defined subsequently.

(5) at the order of the SEC to this and other registered exchanges, adopt rules limiting membership and broker-dealer allowances to bona fide broker-dealers.

Because of the interrelationship of these proposals these courses of action are offered as a package. Further, the specific details of each of the five elements of the package will have to be developed subsequently.

The first proposal described would give directly to large investors, principally institutions, and to the public which has entrusted its funds to institutions, a commission reduction to which they are entitled by size of transaction and which some are presently receiving circuitously.

Continuance of customer directed give-ups on a reduced and controlled basis would tend to eliminate abuse in granting of reciprocals, and would give recognition to the fact that there is more to an order than its execution.

The third proposal, involving an enforcement of rebate rules, would help to eliminate undesirable reciprocal practices and arrangements enaged in by some which through certain other exchanges and the over-the-counter market, result in NYSE commission "leakage".

Because we recognize and respect the desire of non-NYSE brokers to merchandise securities listed on our Exchange profitably, and preferring not to have them compensated by artifice, we propose that certain qualified brokers be given an opportunity to share the commission dollar directly instead of indirectly. The public will be better served and depth and liquidity of markets on our Floor will be improved.

Our last proposal restricting future membership in any exchange to bona fide broker-dealers is necessary to insure the health and vitality of our securities distribution and auction market mechanisms as we know them.

Chairman Gustave Levy and I presented these proposals for consideration by the SEC this morning. I cannot emphasize too strongly the important role that the SEC must play in considering and evaluating the action which has been taken by the Board of Governors.

Subject to Commission reaction, the Cost and Revenue Committee intends to proceed immediately with drafting rules and commission structure to accomplish these ends.

s/Robert W. Haack
Robert W. Haack
President.

FOR RELEASE Friday, January 26, 1963

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Securities Exchange Act of 1934
Release No. 8239

The Securities and Exchange Commission announced that the New York Stock Exchange has submitted for Commission comment and reaction the outlines of a proposal for certain revisions of its commission rate structure. A copy of that proposal is attached to this release. As described more fully below, the Exchange proposal generally contemplates (1) provision for a volume discount in commissions, (2) access to the exchange market for qualified nonmember broker-dealers through a professional discount, (3) recognition of limited customer directed "give-ups" of commissions to both members and nonmembers of New York Stock Exchange executions and limitations upon reciprocal business, (4) a prohibition of procedures by which institutional investors may recapture a portion of the commissions paid by them and (5) a requirement that the regional exchanges impose similar restrictions.

The Commission also announced that it has under consideration a proposal to adopt Rule 10b-10 under the Securities Exchange Act of 1934. The rule, essentially, would prohibit investment company managers from directing brokers executing transactions for an investment company to divide their compensation in any way with other brokers unless the benefits of such division accrue to the investment company and its shareholders. The rule would be adopted pursuant to the antifraud provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 and certain provisions of the Investment Company Act of 1940.

Since the proposal of the Exchange as well as the proposed Commission rule would have significant impact upon New York Stock Exchange member firms, non-member broker-dealers, institutional investors, other exchanges and the public, the Commission believes it appropriate that all interested persons have an opportunity to comment not only on the proposed Commission rule but also on the Exchange's proposal.

Both the proposed Commission rule and the proposal of the Exchange arise out of certain problems presented by the Great increase in institutional investment and the complex and rapidly developing pattern of practices and procedures in the securities markets associated with that increase which are commonly referred to as "give-ups and reciprocal business." Proposed Rule 10b-10 is limited in scope. It assumes that present give-up practices will continue and accordingly deals primarily with the question of conduct by fiduciaries in that context. The New York Stock Exchange proposal is more far reaching and, particularly insofar as it involves a volume discount, suggests the possibility that the problem with which the proposed rule is concerned could be dealt with in a more direct and thorough-going way by changing the commission rate structure. For this reason and because in certain respects the proposed rule of the Commission and the Exchange proposal are inconsistent, the Commission further believes it appropriate to afford interested persons the opportunity not only to comment with respect to both the proposed rule and the Exchange proposal but to suggest, if they so desire, alternative means of dealing with the serious and difficult problems presented.

Any consideration, both of these proposals and of the practices and procedures to which they relate, must include careful attention to their impact upon competition, including competition among securities firms, competition among markets and competition among institutional

investors. This is mandated by the antitrust laws and the policies underlying these laws. As the Supreme Court has pointed out, the Exchange Commission rate structure includes a number of practices which would clearly violate the antitrust laws absent the Securities Exchange Act and notwithstanding the Securities Exchange Act the exchanges do not enjoy a blanket exemption from the antitrust laws. Nevertheless where the Commission has jurisdiction to review and pass upon particular Exchange activities, as it has in the area of commission rates under Section 19(b) of the Exchange Act, antitrust immunity may, under some circumstances, be implied.[1] Such immunity would be implied to the extent necessary to reconcile the statutory scheme of the Securities Exchange Act with that of the antitrust laws. This necessarily contemplates that full consideration be given to the policies of the antitrust laws as well as those of the Securities Exchange Act in evaluating any aspect of the commission rate structure or any proposals for its revision. Whether or not the mere existence of Commission jurisdiction necessarily creates an immunity from the antitrust laws was left open by the Supreme Court in the *Silver* case. However this may be, it is clear that antitrust considerations should receive the closest scrutiny.

BACKGROUND

The Commission believes it useful to outline briefly the situation which prompted both the New York Stock Exchange's rate structure proposal and proposed Commission Rule 10b-10 with the expectation that this may contribute to understanding and analysis of these proposals.

In recent years institutional investors, including banks, insurance companies, pension plans and investment

1. *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963). See also *Kaplan v. Lehman Bros., et al.*, 250 F. Supp. 562 (M.D. Ill., 1965), *aff'd* 371 F. 2d 409 (C.A. 7, 1967). *Certiorari denied.* U.S. , the Chief Justice dissenting, (1967).

companies have accounted for a steadily increasing share of the volume of trading on the exchanges. On the New York Stock Exchange institutional volume as a percent of total public volume has increased from 25.4 percent in March 1956 to 33.8 percent in September 1961, to 39.3 percent in March 1965 and 42.9 percent in October 1966, the latest date available. It should be recognized that these institutional investors usually represent a pooling, under professional management, of savings belonging to a great many individuals, most of whom are small investors. Consequently securities market conditions and practices which affect the investments of these individuals are of wide public interest.

These institutions tend to deal in larger blocks of securities than individual investors ordinarily do. Consequently increasing institutional participation in the exchange markets has been accompanied by a significant increase in the number of large blocks offered and traded. Studies by the New York Stock Exchange show that the number of transactions involving 10,000 shares or more has increased from 2171 in 1965 to 6685 in 1967, that the number of shares involved in these transactions has more than tripled, and that their share of reported volume has increased from 3.1 percent to 6.5 percent.

This situation has thrown an increasing strain on the rigid minimum commission rate structure, adopted many years ago by the New York Stock Exchange and followed by all other national securities exchanges, which is based upon a single round lot, usually 100 shares. There is no volume discount based either on the size of the individual order or upon the amount of portfolio business done by an institution or upon the amount of portfolio business done by an institutional investor over a period of time. Thus the commission which a member firm is required by Exchange rules to charge its customer on a 10,000 share transaction is 100 times the commission it is required to charge on a 100

share transaction and the commission on 100,000 shares is 1000 times the commission on 100 shares. Ostensibly all persons who are not Exchange members must pay the minimum commission. There is no distinction among different kinds of nonmember, e.g., nonmember brokers, individual customers, institutional investors, etc.

While orders to buy or sell large blocks involve greater demands on a broker than the execution of a single round lot order, it does not cost a broker anywhere near 100 times as much to execute a 10,000 share order than to execute a 100 share order. Indeed, for certain aspects of the execution process, such as bookkeeping, the cost is essentially the same. As is true in other areas of the business world, broker-dealers engaged in effecting such transactions have enjoyed the great advantages of scale accruing from large transactions. These institutional transactions generally do not involve the payment of a commission to a salesman of the broker, although an institutional brokerage business usually does entail the expense of maintaining an institutional trading department and the development of special talents. Consequently, the executing brokers are willing to accept substantially less compensation for executing institutional orders, particularly large institutional orders, than is contemplated by mechanical application of the existing minimum commission rate rules of the exchanges.

Managers of institutional investors have taken advantage of the competition among brokers for institutional business, and the willingness of such brokers to accept compensation far lower than that contemplated by the Exchange rules, to divert or recapture portions of the commission paid on institutional orders. An increasingly complex pattern of practices having this objective has developed. Many of these practices involve the so-called "give-up."

A "give-up" is a payment by the executing broker to other broker-dealers of a part of the minimum commission he is required to charge his customers. Under the rules of the stock exchanges, the payment may be made on the executing broker's own initiative and for his own purposes or it may be directed by the customer. The recipient of a "give-up" check may have had nothing whatsoever to do with the transaction for which the commission is charged and in fact may not even know of the transaction or where or when it was executed. Thus "give-ups" have been widely used in connection with mutual fund portfolio transactions. Managers of mutual funds direct give-ups, for the most part to broker-dealers who have sold fund shares in order to motivate, or reward, such sales effort. On certain orders, the executing broker may retain as little as 25 percent of the commission paid by the fund and give up the balance. Brokers who sell fund shares are thus compensated for their efforts not only by receipt of the dealer's portion of the "sales load" but also by substantial amounts of give-up dollars generated at the direction of the manager of the fund through purchases and sales of fund portfolio securities. Fund managers also often use give-ups as a reward for research ideas furnished to them in their capacity as investment advisers to the funds.

While the New York Stock Exchange permits its members to give up commissions only to other members of that Exchange, the smaller regional exchanges have, with increasing success, competed with the New York Stock Exchange for institutional business, particularly the business of mutual funds, by permitting give-ups of commissions not only to members of the particular exchange but also to any member of the National Association of Securities Dealers, Inc. or even to any registered broker-dealer. By requiring that an order be taken to a regional exchange, a mutual fund manager is able to provide monetary reward to broker-dealers who sell shares of the

mutual fund but who are not members of the New York or of any exchange.

Give-ups are widely used in connection with so-called "cross" transactions. These involve situations where the order cannot be adequately executed in the auction process off the floor of an exchange and therefore the institutional broker finds the other side of the trade on the floor, i.e., locates a seller if he has an order to buy or a buyer if he has an order to sell, and then merely records or "crosses" the order on the floor. Exchange rules do not allow member brokers to consummate crosses in their offices or in the over-the-counter market at a negotiated commission, but they do allow the broker to send the transaction to any exchange of which he is a member and to give up from the commissions he must charge on the cross in accordance with the rules of that exchange. By this means large institutional orders can, nominally at least, be executed on small regional exchanges, but where this occurs the usual motive is simply to take advantage of the rules of that exchange with respect to the classes of persons who may receive give-ups.

In addition to the give-up, there have developed complex practices by which executing brokers provide compensation at the direction of institutional investors to other brokers by means of reciprocal business, *i.e.*, permitting such other brokers to participate in the commission generated from execution, in the over-the-counter market or on regional exchanges, of orders which the institutional broker has received from *other* customers. More recently, certain member firms of the New York Stock Exchange have developed a procedure whereby they can compensate nonmembers of the New York Stock Exchange at the direction of mutual fund managers by paying cash to such nonmembers and crediting such payments on over-the-counter trades for unrelated customers, whether or not commissions were in fact charged on such trades. The

compensated dealers have no participation in these trades and, in fact, may never have heard of the trades at the time when they were executed.

Give-ups and reciprocal business practices in connection with institutional trading have become so widespread that it may plausibly be argued that, in the case of large institutional orders, there is in economic substance no fixed minimum commission. Commissions are negotiated between institutional managers and their "lead" brokers with the lead broker on occasion retaining no more than 25 percent of the ostensible minimum commission. This situation is perhaps most strikingly illustrated by procedures which have been developed and which enable institutional investors to recapture a portion of commissions for themselves. Many mutual fund managers have affiliates which are registered as broker-dealers; many of these affiliates are members of the NASD. A small number of mutual fund managers have created affiliates which have joined a regional stock exchange. In the latter situations, the manager directs that give-ups and reciprocal business be given by its lead brokers to its affiliates. It then credits the net income thus received by the affiliate, in whole or in part, against the advisory fee it receives from the fund. This results in lowering the advirosy fee by all or part of the net income the manager has thus obtained. Through this means, public shareholders of institutions can, within the framework of existing practices developed by the securities industry, recoup substantial amounts of commissions actually paid for the execution of their portfolio orders despite a rigid commission structure which does not otherwise permit the institution to benefit from the very substantial portfolio business it may have to dispense. In one instance the advisory fees charged to a large complex of mutual funds by their common manager were lowered in the aggregate by approximately $3.1 million for the year 1966, this sum being the approximate net profit of the

manager's broker-dealer affiliate. Other managers have elected to credit the advisory fees they charge by only 50 percent of the net profits of their broker-dealer affiliates. In a few instances, the mutual fund manager has kept all give-ups it has directed to its brokerage affiliate for itself without lowering the advisory fees it charges to the fund whose portfolio transactions are the source of such give-ups.

Although these techniques permit fiduciaries who manage a pooled fund to return a portion of portfolio commissions to the shareholders of that fund, they have to date been employed mainly by the managers of those mutual funds whose shares are sold by the manager's own "captive" sales force. Managers of these mutual funds which are distributed by independent broker-dealers have almost always used the excess brokerage to provide additional reward to dealers who sell shares of the fund rather than endeavoring to recapture such brokerage for the fund. This is because by so compensating dealers these mutual fund managers facilitate the sale of shares and thus maximize their own underwriting and investment advisory income. Many mutual fund managers believe that so long as this type of sales incentive can be given to dealers, competition among mutual fund managers for the favor of dealers will make it difficult, if not impossible, for any individual fund manager to fail to provide such compensation to dealers, both members and nonmembers of exchanges, selling shares of his funds. In this connection the Commission has been informed that certain large member firms of the New York Stock Exchange, who maintain extensive mutual fund departments and are a significant factor in the sale of mutual fund shares through dealers, have suggested to mutual fund managers that brokerage be channeled to them if they are to continue to sell shares of the manager's funds.

The net effect of the foregoing development have been (2) a dramatic increase in the volume of transactions on regional exchanges,[2] (2) a "diversion" of commissions which otherwise might have been retained by New York Stock Exchange members to (a) other members who perform no function in connection with transactions and (b) non-members of the New York Stock Exchange who perform no function on transactions effected by New York Stock Exchange members on regional exchanges, and (3) a developing trend whereby excess commissions—the amounts which, at the direction of institutional managers, executing brokers are willing to give up to persons who perform no service or function in connection with the execution of portfolio transactions—are returned, at least partially, to the institutional customers thereby indirectly benefiting the millions of investors who invest through pooled media such as mutual funds. In short, competition in the securities industry between institutional managers and brokers and between exchanges, has operated to reduce very substantially the amount of commissions actually *retained* by executing brokers—but with relatively little impact or effect as yet on the commissions actually *paid* by the public investors who invest through institutional media.

In addition to practices with respect to commissions on institutional transactions, there are certain related competitive phenomena which deserve mention. As previously noted, the New York Stock Exchange rate structure ex-

2. In 1961 the total dollar volume of transaction, on regional exchanges was $4.4 billion, in 1966 it was $10.3 billion. This represented 6.8 percent of the dollar volume of transactions on all exchanges in 1961 and 5.4 percent of such volume in 1966. By comparison New York Stock Exchange dollar volume increased from $52.7 billion in 1961 to $93.6 billion in 1966, and New York Stock Exchange transactions de lined from 32.6 percent of total dollar volume of exchange transaction in 1961 to 30.1 percent of such transactions in 1966. Dollar volume on the American Stock Exchange accounts for the balance. Substantially all of the regional exchange volume consists of trading in securities also traded on the New York Stock Exchange.

pressly provides that nonmembers of that Exchange—including broker-dealers who are members of a regional exchange—must pay a New York Stock Exchange member a full commission for transactions executed on the New York Stock Exchange. Neverthtlees, reciprocal business practices have developed which now give such regional exchange members indirect economic access to the floor of that Exchange.

For example, when a broker-dealer cannot execute its customer's order on the regional exchange of which it is a member, it has the order executed on the New York Stock Exchange, pays a New York Stock Exchange member a full New York Stock Exchange commission and collects that amount from the customer. Thus, the sole member of the regional exchange receives no direct compensation for its customer's order. However, it can receive indirect compensation equal to 50 percent of the commission paid by the customer. The member of the New York Stock Exchange through whom the order was executed brings its own customers' orders to the regional exchange, executes them there and names the sole member broker-dealer as the "clearing agent." Typically, under the rules of regional exchanges, the sole member may receive up to 50 percent of the stock exchange commission for acting as "clearing agent" on such orders, although he performs no function except the largely unnecessary one of guaranteeing performance by the New York Stock Exchange member.

Recent years have also seen a substantial growth in the so-called third market. This involves securities firms which are not members of any exchange and which deal in listed securities over-the-counter, both as principal and as agent, largely for institutional customers and broker-dealers not members of an exchange. Since exchange minimum commission rates do not apply to them, they have been able to execute orders either as principal or as agent for compensation substantially less than that provided for in the

minimum commission rate rules. On the other hand, their ability to compete for institutional business has been adversely influence by the fact that they are not in a position to provide give-ups for the benefit of institutional managers, since give-ups have generally been regarded as proper only where a minimum commission rate is applicable. Two incidents illustrate this point. One firm at one time specialized in executing institutional orders for listed securities in the over-the-counter market at a negotiated commission lower than that provided by exchange rules. Certain mutual fund managers suggested that it join a regional exchange and thus charge the higher commissions specified by the exchange and, at the same time, place itself in a position to distribute give-ups at the request of these managers and it did so in order to retain their business. Another large over-the-counter firm advised the Commission that instead of negotiating its compensation on each large institutional trade, it proposed unilaterally to establish a fixed non-negotiable commission but to give up a portion of this commission at the direction of mutual fund managers. This arrangement, which has not yet been put into effect, was motivated not because the firm thought that its existing negotiated compensation was inadequate but, rather, because it believed that its ability to provide give-ups would substantially improve its competitive position in seeking business from mutual fund managers even though its regular charges imposed on the funds were already lower than the New York Stock Exchange fixed minimum commission.

The Commission's jurisdiction under Section 19(b) of the Securities Exchange Act over Exchange rules with respect to "the fixing of reasonable rates of commission" obviously extends both to the commission rate level and to the commission rate structure. Particularly in the earlier years the Commission's attention appeared to focus primarily on questions of level, although questions of structure also arose. The history of this consideration since 1937 is

outlined in considerable detail in the Report of the Special Study of Securities Markets.[3] As there pointed out, determination of a reasonable level of minimum rates for an industry as diverse, complex and, in a sense, competitive as the New York Stock Exchange brokerage community presents perplexing problems. In addition, questions of structure and questions of level are intimately related. Thus the Exchange proposal for a volume discount pertains to rate level as well as structure and is a response to the fact that the existing level of rates for large institutional transactions has, as a result of competitive factors, fostered the proliferation of give-ups and reciprocal practices.

These practices and problems, as outlined above, some of which are of relatively recent origin, have been the subject of intensive consideration by the Commission over a period of years. Reciprocal business practices and customer directed give-ups were described in the Report of the Special Study of Securities Markets.[4] It was suggested that they be studied in connection with an intensive inquiry into all aspects of the commission rate structure. They were further discussed in the Commission's 1966 Report on the Public Policy Implications of Investment Company Growth.[5] Approximately 19 months ago the Commission advised the exchanges of its belief that Exchange rules should be changed to preclude customer directed give-ups.[6]

Since consideration of the New York Stock Exchange proposal necessarily would involve an understanding and

3. Special Study, Pt. 2, 328-346. H.R. Doc. No. 95, 58th Cong., 1st Sess. (1963).

4. Special Stucy, *supra*, 301, 318.

5. Mutual Fund Report, Chapter 4, pp. 162-188.

6. Mutual Fund Report, Chapter 4, pp. 135-136.

consideration of possible alternatives, the Commission believes that proposed Rule 10b-10 should now be noticed for comment. The Commission would thus be in the best position to consider all alternatives, including any which may be suggested.

THE EXCHANGE PROPOSAL

The first item of the New York Stock Exchange proposal involves the establishment of a volume discount. The Exchange has not yet determined the amount of such discount or the circumstances under which it would be available. There are a number of possible alternatives, including (1) a discount based upon the size of a particular order and (2) a discount based upon the volume of a particular investor's transactions over a specified period of time. The Commission assumes that the discount ultimately arrived at would be meaningful and workable. Upon that assumption it would appear that this part of the Exchange proposal would make an important contribution to resolving the problems discussed above and be in accord with suggestions that the Commission has made to the exchanges on several occasions.

Several other parts of the Exchange proposal appear to be based on the view that (1) the relatively untrammeled development of reciprocal and give-up practices, (2) the competitive advantages which regional exchanges have sought in competing for institutional business by increased liberality with respect to give-ups, and (3) the resulting "leakage" of commissions outside the New York Stock Exchange community, as threatening impairment of the depth and liquidity of the New York Stock Exchange market as well as the profitability and financial stability of member firms.

The Exchange proposal seeks to relieve this situation by (1) limiting to the extent possible the major types of reciprocal business, (2) specifying the maximum percentages of the commission dollar which may be given away

in any manner or, alternatively, specifying the minimum amount which must be retained, (3) preventing the regional exchanges from offering different and more liberal give-up arrangements so that institutional or other investors will not seek to execute or cross their transactions on regional exchanges in order to obtain more favorable give-ups, and (4) preventing what is some times referred to as "institutional membership" on exchanges, which appears to include membership of affiliates of an institutional investor whose function is to receive give-ups and reciprocal business and in whole or in part to pass the income therefrom back to the institutional investor itself. This is a significant part of the New York Stock Exchange proposal which would have a particularly important effect upon the securities markets, and would require action by the Commission. Consequently, comment with respect to it would be appreciated. These aspects of the Exchange's proposal may be viewed together as designed to make its minimum commission rates effective and enforceable insofar as large institutional transactions are concerned.

It would appear that the New York Stock Exchange proposal could have a substantial impact on the regional exchanges. A primary method by which regional exchanges have competed for the portfolio business of institutions has been to offer institutional managers a more flexible rate structure than that of the New York Stock Exchange, *i.e.*, by permitting give-ups to a wider category of persons. Regional exchanges rely heavily on reciprocal business patterns which permit their sole members (nonmembers of the New York Stock Exchange) to obtain indirect access to the New York Stock Exchange. In this connection regional exchange rules facilitate reciprocal business practices by which dual members (members of the New York Stock Exchange and a regional exchange) compensate members of regional exchanges for business executed on the New York Stock Exchange. The New York Stock Exchange proposal would curtail such practices. It also would prevent

institutions from obtaining membership on regional exchanges or otherwise engaging in reciprocal business practices which, in effect, reduce the portfolio commissions such institutions pay. Both the impact and the significance of the Exchange proposal, insofar as it involves the regional exchanges, are affected by a change which has taken place in the primary function of the regional exchanges. These exchanges were originally conceived of as primarily providing local markets for local securities. With the passage of time, the emphasis on most of the regional exchanges has shifted to providing a local market for securities traded on the New York Stock Exchange. Technical improvements in communication and the development of over-the-counter markets for local securities have contributed importantly to this change in the nature of the regional exchanges. As pointed out above, in many instances the participation of certain regional exchanges amounts to no more than providing a location where privately negotiated "cross" transactions in New York Stock Exchange listed stocks are recorded and give-ups are distributed.

Finally, the New York Stock Exchange proposal permits the continuation of customer directed give-ups and would expand them to provide for give-ups to nonmember broker-dealers of the New York Stock Exchange on executions on that Exchange. It would also provide for minimum retentions by executing brokers. The justification for these restrictions presumably is that competition in liberality with respect to customer directed give-ups is not a desirable form of competition and that the economic health of the exchange community calls for a sharp and enforceable distinction between public customers and the brokerage industry.

Certain aspects of the New York Stock Exchange proposal are not specific, *i.e.*, the amount, kind, or applicability of the volume discount, the percentage of the

COMMISSION AS A PERCENT OF VALUE FOR VARIOUS PRICED STOCKS AT SELECTED ORDER SIZES UNDER PRESENT AND PROPOSED COMMISSION RATES

Trade Size	Commission As Percent of Value Under Present Commission Rates — Price Per Share					Commission as Percent of Value Under Proposed Commission Rates — Price Per Share				
	$10	$20	$30	$60	$100	$10	$20	$30	$60	$100
Shares	$10	$20	$30	$60	$100	$10	$20	$30	$60	$100
100-400	1.70	1.35	1.13	0.75	0.49	1.60	1.30	1.10	0.80	0.68
Value	1.70	1.35	1.13	0.75	0.49	0.93	0.82	0.78	0.75	0.68
30,000 $60,000	1.70	1.35	1.13	0.75	0.49	0.73	0.73	0.69	0.64	0.63
20,000	1.70	1.35	1.13	0.75	0.49	0.72	0.68	0.62	0.59	0.57
360,000	1.70	1.35	1.13	0.75	0.49	0.705	0.65	0.58	0.55	0.54
720,000	1.70	1.35	1.13	0.75	0.49	0.70	0.64	0.575	0.54	0.53
2,160,000	1.70	1.35	1.13	0.75	0.49	0.70	0.633	0.57	0.54	0.52
10,800,000	1.70	1.35	1.13	0.75	0.49	0.70	0.63	0.57	0.53	0.52

minimum commission which a nonmember could receive and the qualifications which non-members would have to have in order to become eligible for this "access" and the amount of customer directed give-ups available to members and nonmembers, etc. Further, the Exchange proposal does not indicate whether the Exchange contemplates revision of the commission rate rules to relate commissions more directly to the money involved in a transaction rather than to the number of shares, thus modifying the existing disparity in commissions paid for a given investment in low priced stocks and in high priced stocks. This matter was discussed in a report to the exchange community from Mr. G. Keith Funston, then president of the Exchange, on July 21, 1967. Revisions along this line, as suggested by Mr. Funston, would not only modify this disparity but might provide a convenient way of introducing the proposed volume discount.

The Exchange apparently is initially concerned with the principles and objectives underlying its proposal. In this connection, the Commission assumes that if these principles and objectives are accepted, the Exchange will determine the specifics, *i.e.*, the dollar amounts, the percentages and the definitions, in such a way that the proposal will accomplish its intended purpose. Thus, for example, nonmembers would be offered a sufficient participation in commissions to induce them to bring their orders to the Exchange. The Commission understands that New York Stock Exchange members would be required to retain approximately 50 percent of the commission on any order with the balance available for customer directed give-ups.

The Commission believes that it is possible and appropriate for interested persons to express their views on the principles underlying the Exchange's proposal and the means by which its objectives may be accomplished even though, in the absence of more specific proposals, it may

not be possible to determine the specific financial impact of various parts of the proposal on the earnings of various members and nonmembers or on the amount of commissions which institutional investors would pay.

PROPOSED COMMISSION RULE 10b-10

Proposed Rule 10b-10 represents an approach to the give-up problem which would not require significant change in the existing commission rate structure of exchanges nor require all exchanges to adopt a uniform approach to the question of give-ups and reciprocal business.

The Commission recognizes that the proposed rule is not a substitute for full reexamination of the structure and rates of commissions on the national securities exchanges. The proposed rule was under consideration prior to the announcement of the New York Stock Exchange proposal and has its antecedents in the Commission's Report on Investment Company Growth, which stated at p. 173:

> "It would not be inconsistent with [the] rules [of certain regional stock exchanges] for dealer-distributed funds to direct give-ups to their adviser-underwriters, all of whom are NASD members, for the purpose of applying these give-ups to reduce the advisory fees payable by the fund.[82]
>
> "82. Alternatively, the fund itself could form a broker-dealer affiliate to which it could direct give-ups. If this course were followed—and no fund now does so—the give-ups would inure to the direct benefit of the fund's shareholders."

The reasoning on which the proposed rule is based is that if, as pointed out above, a mutual fund manager has various means at his disposal to recapture for the benefit of the fund a portion of the commissions paid by the fund, he is under a fiduciary duty to do so. Furthermore, diversion

of such commissions to benefit an investment company manager may be viewed as additional compensation to the manager for handling the portfolio transactions of the fund within the meaning of, and in violation of, Section 17(e)(1) of the Investment Company Act.[7]

The proposed rule therefore reflects a duty on the part of mutual fund managers as fiduciaries not to use commissions paid by their beneficiaries for the benefit of the fiduciary when practices, procedures, and rules of the markets in which such fiduciaries act permit their beneficiaries to receive tangible benefits in the form of reduction of the charges now borne by them. The proposed rule is bottomed on the premise that when a fiduciary uses commissions to obtain benefits for himself under these circumstances, his conduct would appear to violate applicable antifraud provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 as well as Section 17(c) of the Investment Company Act, particularly in view of the obscure and often devious ways in which this is accomplished. The proposed rule would be adopted pursuant to Sections 10(b) and 15(c)(1) and (2) and 23(b) of the Securities Exchange Act of 1934, Sections 206(4) and 211(a) of the Investment advisers Act of 1940 and Sections 17(e) and 38(a) of the Investment Company Act.

The proposed rule would not impair the competition which now exists among brokers and among exchanges for the business of institutional customers by offering these customers substantial savings on commissions. On the

7. The Commission does not believe that investment company directors may properly view the benefits derived by fund managers from give-ups as simply an additional form of compensation for investment management. Not only may this run afoul of Section 17(c)(1) of the Investment Company Act but the benefits derived by investment company managers from this source cannot be precisely or adequately disclosed in the prospectus, or in the investment advisory contract, as is required by Section 15(a)(1) of the Investment Company Act.

contrary, the proposed rule recognizes that, as mentioned above, developments and competitive forces in the securities markets have, as an economic matter, tended to eliminate the existence of a fixed minimum commission rate on institutional orders.

The proposed rule would read as follows:

"Rule 10b-10

"(1) It shall be unlawful for any registered investment company or affiliated person of such registered investment company* to directly or indirectly, to order or request any broker or dealer:

"(a) to pay or arrange for the payment, directly or indirectly, of all or any portion of a commission on any securities transaction to any broker, dealer or any other person *unless* pursuant to a written contract the full amount of such remittance is required to be paid over to such registered investment company, or fees owed by or charged to such registered investment company are required to be reduced in an amount equal to the remittance;

"(b) to designate or employ any broker or dealer on any transaction to transmit, execute or clear a transaction or to perform any other function for which compensation is required or made *unless* pursuant to a written contract the

* Although the proposed rule is couched only in terms of persons who are affiliates of and fiduciaries to investment companies, the principles which are set forth above may be equally applicable to other managers of pooled funds who act in a fiduciary capacity and who are able to reduce the portfolio commissions of their beneficiaries. To the extent that such managers direct give-ups for their benefit, when they are in a position to utilize them for the benefit of beneficiaries, it would appear that under the Federal Securities Laws or otherwise, this use of give-ups other than for the benefit of these beneficiaries would also constitute an improper practice by such fiduciaries. Accordingly, the Commission believes that it is appropriate to solicit comment on this issue and will consider whether the proposed Rule 10b-10 should be applicable to other fiduciaries who manage pooled funds.

full amount of such compensation is required to be paid over to such registered investment company or fees owed by or charged to such registered investment company are required to be reduced in an amount equal to such compensation.

"(2) For the purposes of this rule a person is affiliated with a registered investment company if such person:

"(a) is an officer, director, trustee, employee, investment adviser, member of an advisory board, depositor, promoter of or principal underwriter for the registered investment company, or

"(b) directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with the registered investment company, its investment adviser or principal underwriter, or

"(c) directly or indirectly owns, controls, or holds with the power to vote, five per centum or more of the outstanding voting securities of the registered company."

While the New York Stock Exchange proposal and proposed Rule 10b-10 are not mutually exclusive on all points, the New York Stock Exchange proposal is, to a significant extent, an alternative approach. Insofar as the New York Stock Exchange proposal would provide institutional investors with a volume discount while at the same time closing, insofar as possible, the various avenues by which an institutional manager can recoup commissions for the benefit of the fund, it could, depending upon the nature and extent of the volume discount, provide a direct rather than an indirect means by which institutional investors may obtain the benefit of lower charges. To the extent that it would make impossible indirect recoupment

of commissions by institutional managers, the question of a fiduciary duty on their part to seek such recoupment would not arise.

All interested persons are invited to submit their views and comments on proposed Rule 10b-10 in writing to the Secretary, Securities and Exchange Commission, at its principal office, 500 North Capitol Street, Washington, D.C. 20549, on or before March 1, 1968. The Commission also invites comments on the New York Stock Exchange proposal which is set forth in the attachment of this release, as well as any alternative suggestions for dealing with the problems presented. Material submitted will be made available for public inspection unless request for confidential treatment is made.

By the Commission.

Orval L. DuBois
Secretary

Attachment

NEW YORK STOCK EXCHANGE
Eleven Wall Street
New York, N.Y. 10005
Robert W. Haack
President

January 2, 1968

TO: Members and Allied Members
SUBJECT: *Commission Rate Structure Proposal*

A principal unsolved problem facing the securities industry is that involving the New York Stock Exchange commission rate structure. The complexities and ramifications are such that they are not generally understood even though they directly or indirectly affect the New York Stock Exchange and its members, regional exchanges and their members, the third market, non-member broker-dealers, institutional investors and, of course, the public.

The problem has become more acute by reason of certain pressures which are building up in Congress, government agencies and departments, a segment of the press and the SEC which has oversight responsibilities in the area. The issue is further complicated by the fact that the Exchange, enjoying the privilege of self-regulation and operating under a government approved commission rate structure and certain anti-trust immunities, has an obligation to review its fees and industry developments and practices in the light of public interest. This is a problem which cannot be solved by the Exchange alone. However, inaction on our part is apt to result in the problem being solved by those outside the industry who may be less familiar with the ramifications and as a result might direct changes less satisfactory than those we initiate.

The minimum commission rate is ceasing to be a "minimum" because of practices which have developed and which are proliferating. This is the case in large measure because certain institutional investors are

naturally desirous of achieving a lower commission rate on large transactions, and brokers who are non-members of this Exchange are understandably interested in achieving access to the commission dollar. To accomplish these objectives, among others, a wide range of devices is being employed. Membership on regional stock exchanges, used in both simple and complex reciprocal arrangements related to NYSE transactions, has resulted in a practical access to the New York Stock Exchange. Other practices have in effect given certain institutions commission discounts. One exchange, by permitting rebates to SECO members, in effect is giving a public and institutional discount. Through complicated arrangements there are now certain sophisticated individuals who manage to receive 40% rebates on their listed transactions. The net result, in brief, is an intricate maze involving give-ups, give-aways, reciprocal practices, manufactured participations in trades, transported trades moved from one Exchange to another, all of which result in a leakage of the commission dollar.

The situation also reflects a commission structure which was most recently revised in 1959 and which does not properly recognize significant changes which have since taken place in the mix of our business. We are all aware of the increased institutional activity which is one of the significant phenomena of our time and which in all likelihood will continue to grow. It seems reasonable that institutional business with its unique characteristics and demands must be recognized in our commission charges. Moreover, failure to recognize and speak to the problem will inevitably result in a diversion of activity to competing marketplaces.

Because of all of the foregoing, the Board of Governors has unanimously adopted a resolution which had earlier been recommended by the Cost and Revenue Committee and which has the further approval of the Regional Firms

Advisory Committee and the Liaison Committee of the Association of Stock Exchange Firms to the effect that the New York Stock Exchange proposes to

(1) incorporate a volume discount in the minimum commission schedule, the amount and nature of such discount to be subsequently determined.

(2) support continuation of the practice of customer directed give-ups on their own transactions with a limitation on the percentage amount which may be so given-up.

(3) take steps to prohibit reciprocal practices which result in de facto rebates of NYSE commissions even where those arrangements involve other markets than the NYSE floor, provided that the SEC will aid in prohibiting such practices in other markets.

(4) allow a discount in the minimum commission schedule for non-member brokers, both domestic and foreign, with qualifications to be specifically defined subsequently.

(5) at the order of the SEC to this and other registered exchanges, adopt rules limiting membership and broker-dealer allowances to bona fide broker-dealers.

Because of the interrelationship of these proposals these courses of action are offered as a package. Further, the specific details of each of the five elements of the package will have to be developed subsequently.

The first proposal described would give directly to large investors, principally institutions, and to the public which has entrusted its funds to institutions, a commission reduction to which they are entitled by size of transaction and which some are presently receiving circuitously.

Continuance of customer directed give-ups on a reduced and controlled basis would tend to eliminate abuse in

granting of reciprocals, and would give recognition to the fact that there is more to an order than its execution.

The third proposal, involving an enforcement of rebate rules, would help to eliminate undesirable reciprocal practices and arrangements engaged in by some which through certain other exchanges and the over-the-counter market, result in NYSE commission "leakage".

Because we recognize and respect the desire of non-NYSE brokers to merchandise securities listed on our Exchange profitably, and preferring not to have them compensated by artifice, we propose that certain qualified brokers be given an opportunity to share the commission dollar directly instead of indirectly. The public will be better served and depth and liquidity of markets on our Floor will be improved.

Our last proposal restricting future membership in any exchange to bona fide broker-dealers is necessary to insure the health and vitality of our securities distribution and auction market mechanisms as we know them.

Chairman Gustave Levy and I presented these proposals for consideration by the SEC this morning. I cannot emphasize too strongly the important role that the SEC must play in considering and evaluating the action which has been taken by the Board of Governors.

Subject to Commission reaction, the Cost and Revenue Committee intends to proceed immediately with drafting rules and commission structure to accomplish these ends.

s/ Robert W. Haack,
Robert W. Haack,
President

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

As you are aware, the commission rate structure of national securities exchanges has been the subject of extensive and continuing study by the Commission. It has become apparent in the course of that study that the present minimum rate structure has led to the development of practices designed to avoid the purported restrictions against the negotiation and the reduction of commission rates. We believe it is now generally recognized that changes in the present commission rate structure are required to benefit the investing public.

The Commission will hold public hearings under Section 21(a) of the Securities Exchange Act of 1934 commencing July 1, 1968, on the question of the commission rate structure of national securities exchanges. A copy of the order for public hearings is enclosed. One subject of these hearings will be whether, in view of present practices, a minimum exchange commission rate structure is necessary, and if so to what extent, in order to achieve the objectives of the Securities Exchange Act of 1934.

The Commission hereby makes written request pursuant to Section 19(1) of the Securities Exchange Act that your Exchange effect on its own behalf changes, to become effective on or before September 15, 1968, in its rules, policies and practices in respect of its commission rate by modifying Article XV, Section 2(a)(1) and appropriate other sections of the exchange constitution and rules either (a) in accordance with the revised minimum commission rates as set forth in Attachment A, or alternatively, (b) by eliminating, with respect to orders in excess of $50,000,

requirements for minimum rates of commission. You should also implement appropriate reductions in the current intra-member rate for non-executing firms or eliminate requirements for minimum intra-member charges to such non-executing firms.

We wish to emphasize that this request is intended as an interim step and that the Commission has reached no definitive conclusion on whether the particular rates described in Exhibit A would reflect the optimum form of rate structure for your exchange or that any schedule of specified rates would provide a complete answer to the problems raised in Release No. 8259 and the comments thereon. Additional measures with respect to other matters, including give-ups, are under continuing consideration and will be examined in the course of the hearing commencing July 1, 1968.

The request that your exchange take the foregoing steps is made in the context of the Commission's responsibilities to consider the national policies embodied both in the securities laws and in the antitrust laws. It is based upon the deficiencies in the present exchange rate structure which fails to provide appropriate discounts but permits give-ups directed by institutional managers, with consequent departures from the purported minimum rate structure on an arbitrary and discriminatory basis.

Sincerely,

Manuel F. Cohen
Chairman

Enclosures

For RELEASE Tuesday, May 28, 1968

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 8324

The Securities and Exchange Commission announced that it has issued an order for the institution of an investigation and a public investigatory hearing, pursuant to Section 21(a) of the Securities Exchange Act of 1934 to consider whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges respecting commission rate structure.

Information developed by the Commission has led it to conclude that present commission rate structure rules, practices and policies do not, in fact, provide for fixed minimum commission charges on many exchange transactions. As an interim measure the Commission has written a letter to the New York Stock Exchange, pursuant to the provisions of Section 19(b) of the Securities Exchange Act of 1934, specifically requesting it to adopt a revised commission rate schedule which would, among other things, provide for reduced rates for that portion of an order involving round lots in excess of 400 shares or, alternatively, to eliminate requirements for minimum rates of commission for all orders in excess of $50,000. That letter also requests the New York Stock Exchange to implement appropriate reductions in the current intra-member rate for non-executing firms or to eliminate requirements for minimum intra-member charges to such non-executing firms. Letters also have been written to the other registered national securities exchanges suggesting that they consider adopting appropriate interim changes in their rules, practices and policies relating to commission rate structure. These proposed interim changes also will provide a focus for the evidence to be introduced in the

public hearing to be held pursuant to Section 21(a).

The Order, a copy of which is attached to this Release, directs that public hearings will be held in Washington, D.C., commencing on July 1, 1968. It describes in general the matters which will be the subject of the investigation and public hearing. The Commission, in a subsequent release, will describe the procedures to be followed with respect to the hearings.

The investigatory hearing is intended to assist the Commission in the discharge of its responsibility under Section 19(b) of the Exchange Act and other provisions of the securities laws. It is not a substitute for, and its pendency will not preclude, more specific procedures to consider or require specific changes in exchange rules and practices either at the instance of the Commission or at the instance of the exchanges on matters set forth in the attached Order.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
May 28, 1968

In the Matter of
COMMISSION RATE STRUCTURE OF
REGISTERED NATIONAL SECURITIES EXCHANGES

ORDER DIRECTING PUBLIC INVESTIGATION AND DESIGNATING OFFICERS TO TAKE TESTIMONY

I.

The Commission, on January 25, 1968, published Securities Exchange Act Release No. 5239 announcing that it had under consideration a proposal to adopt Rule 181-10 under that Act and that the New York Stock Exchange had submitted for Commission correct and reaction the outline of a proposal for certain revisions of its commission rate structure.

The responses to Release No. 5239 and other information made available to the Commission indicate that the practices, procedures and exchange rules relating to exchange commission rate structures involve a number of matters such as (i) commission rate terms for exchange members (Intra-member rates) and for non-members, (ii) the services for which each commission rates pay and the costs allocated thereto, (iii) give-ups and reciprocal practices among different categories of members and non-members, (iv) membership by financial institutions, (v) economic access to embargo markets by non-member broker-dealers, (vi) competition among exchanges and among exchanges and other markets, and (vii) the necessity for restrictions on access of exchange members to the third market.

II.

The Commission deems it necessary and proper to aid in the enforcement of the provisions of the Securities Exchange Act of 1934 and other Acts administered by the Commission and to determine the reasonableness of the commission rate structure of national securities exchanges, that as investigation be made of practices, procedures and rules of registered national securities exchanges for the purposes of protecting investors and for insuring fair dealing in securities traded upon such exchanges and fair administration of such exchanges.

III.

IT IS ORDERED, pursuant to the provisions of Section 21(a) of the Exchange Act, that an investigation be made of the matters referred to in Section I hereof to aid both in the enforcement of the provisions of the Securities Exchange Act and in the prescribing of rules and regulations pursuant to Sections 10(b), 15(b), 17(a), 19(b) and other pertinent provisions of the Exchange Act and other Acts administered by the Commission; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 22 of the Exchange Act, that a public hearing shall be held as part of this investigation, that the public hearing shall be conducted before the Commission, any member or members thereof, or Roger S. Foster who is hereby named as hearing officer and impowered to administer oaths and affirmations and perform all other duties in connection therewith as prescribed by law, at the hearing which shall commence at 500 North Capitol Street, Washington, D.C., on July 1, 1968; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 21(b) of the Exchange Act, that for the purpose of such investigation and public hearing held as part of it Irving H. Pollack and Eugene H. Rotberg and each of them, is hereby designated an officer of this

Commission and shall conduct the investigation and perform all other duties in connection therewith as prescribed by law.

By the Commission.

Orval L. DuBois
Secretary

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

May 29, 1968

Division of
Trading and Markets

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, N.Y. 10005

Dear Bob:

I am enclosing, for your information, a table which compares the present commission rate structure with a revised rate structure which the Commission requested the New York Stock Exchange to adopt pursuant to Section 19(b) of the Securities Exchange Act of 1934. We will send you more detailed information in the next few days.

If you have any questions, please do not hesitate to call me (Area Code 202 963-5151) or Eugene H. Rotberg (Area Code 202 962-4217).

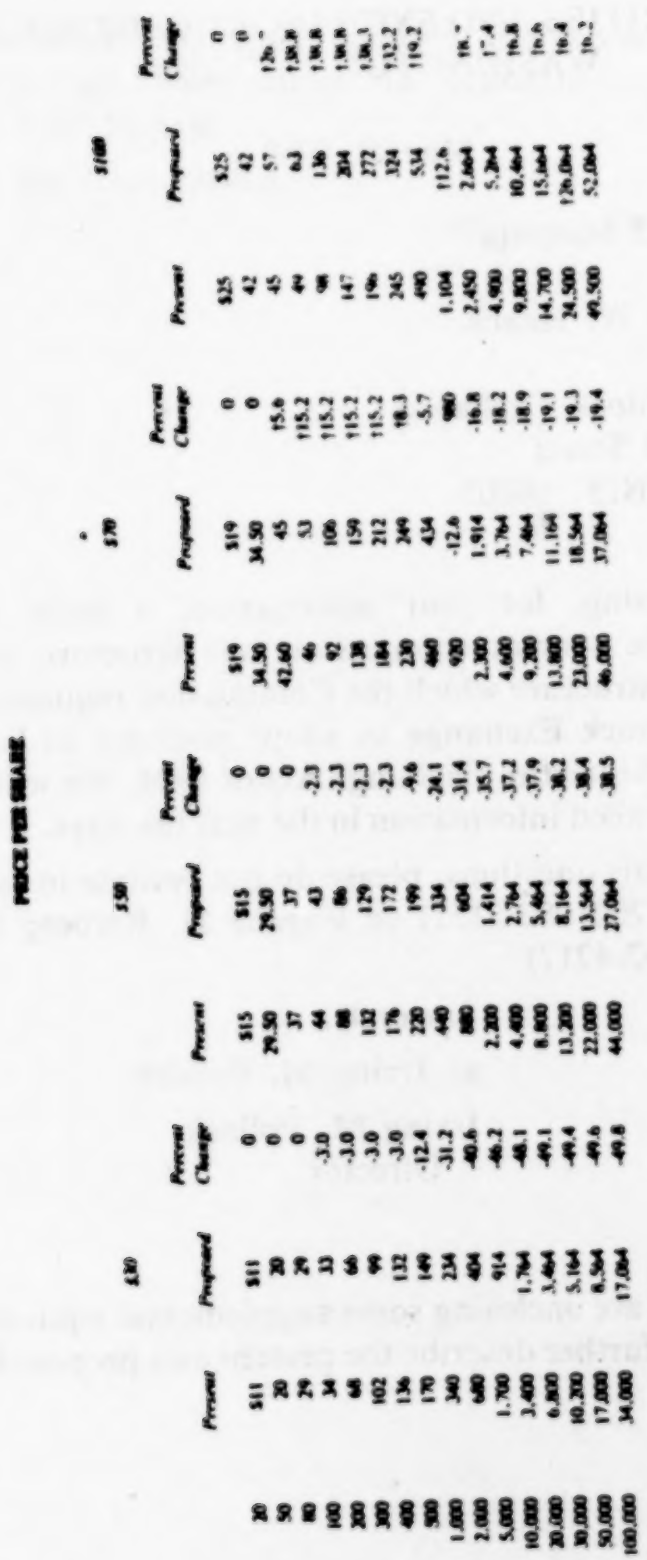
Sincerely,

s/ Irving M. Pollack

Irving M. Pollack
Director

Enclosures

P.S. We also are enclosing some supplemental equivalence tables which further describe the present and proposed rate structure.



LETTER DATED MAY 31, 1968

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 10549

May 31, 1968

Mr. Robert W. Haack, President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Bob:

Enclosed is another table which compares the present and proposed commission rates as a percentage of various dollar value trades.

Sincerely yours,
s/Irving M. Pollack
Irving M. Pollack
Director

Enclosure

EXCHANGE COMMISSIONS UNDER PRESENT AND PROPOSED RATES

$20 stock

Number of Shares	Value of Trade	Present Rate			Proposed Rate			Percent Change Between Present and Proposed Rates
		Amount	As % of Value	Average Commission Per 100 Shares	Amount	As % of Value	Average Commission Per 100 Shares	
100	$2,000	$27	1.35%	$27	$26	1.30%	$26.00	-3.7%
200	4,000	54	1.35	27	52	1.30	26.00	-3.7
300	6,000	81	1.35	27	78	1.30	26.00	-3.7
400	8,000	108	1.35	27	104	1.30	26.00	-3.7
500	10,000	135	1.35	27	116	1.16	23.20	-14.1
1,000	20,000	270	1.35	27	176	0.88	17.60	-34.8
2,000	40,000	540	1.35	27	296	0.74	14.80	-45.2
5,000	100,000	1,350	1.35	27	656	0.66	13.12	-51.4
	200,000	2,700	1.35	27	1,256	0.63	12.56	-53.5
50,000	1,000,000	13,500	1.35	27	6,056	0.61	12.11	-55.1

EXCHANGE COMMISSIONS UNDER PRESENT AND PROPOSED RATES

$40 stock

Number of Shares	Value of Trade	Present Rate			Proposed Rate			Percent Change Between Present and Proposed Rates
		Amount	As % of Value	Average Commission Per 100 Shares	Amount	As % of Value	Average Commission Per 100 Shares	
100	$4,000	$39	0.975%	$39	$38	0.95%	$38.00	-2.6%
200	8,000	78	0.975	39	76	0.95	38.00	-2.6
300	12,000	117	0.975	39	114	0.95	38.00	-2.6
400	16,000	156	0.975	39	152	0.95	38.00	-2.6
500	20,000	195	0.975	39	178	0.89	35.60	-3.7
1,000	40,000	390	0.975	39	284	0.71	28.40	-27.2
2,000	80,000	780	0.975	39	504	0.63	25.20	-35.4
5,000	200,000	1,950	0.975	39	1,164	0.58	23.28	-40.3
10,000	400,000	3,900	0.975	39	2,264	0.57	22.64	-41.9
000	2,000,000	19,500	0.975	39	11,064	0.55	22.13	-43.3

EXCHANGE COMMISSIONS UNDER PRESENT AND PROPOSED RATES

$60 Stock

		Present Rate			Proposed Rate			Percent Change Between Present and Proposed Rates
Number of Shares	Value of Trade	Amount	As % of Value	Average Commission Per 100 Shares	Amount	As % of Value	Average Commission Per 100 Shares	
100	$6,000	$45	0.75%	$45	$48	0.80%	$48.00	-6.7
200	12,000	90	0.75	45	96	0.80	48.00	-6.7
300	18,000	135	0.75	45	144	0.80	48.00	-6.7
400	24,000	180	0.75	45	192	0.80	48.00	-6.7
500	30,000	225	0.75	45	224	0.75	44.80	-0.4
1,000	60,000	450	0.75	45	384	0.64	38.40	-14.7
2,000	120,000	900	0.75	45	704	0.59	35.20	-21.8
5,000	300,000	2,250	0.75	45	1,664	0.55	33.28	-26.0
10,000	600,000	4,500	0.75	45	3,264	0.54	32.64	-27.5
50,000	3,000,000	22,500	0.75	45	16,064	0.54	32.13	-28.6

EXCHANGE COMMISSIONS UNDER PRESENT AND PROPOSED RATES

$80 stock

		Present Rate			Proposed Rate			Percent Change Between Present and Proposed Rates
Number of Shares	Value of Trade	Amount	As % of Value	Average Commission Per 100 Shares	Amount	As % of Value	Average Commission Per 100 Shares	
100	$8,000	$47	0.59%	$47	$58	0.72%	$58.00	†23.4%
200	16,000	94	0.59	47	116	0.72	58.00	†23.4
300	24,000	141	0.59	47	174	174	0.72	58.00
400	32,000	188	0.59	47	232	0.72	58.00	†23.4
500	40,000	235	0.59	47	274	0.68	54.80	†16.8
1,000	80,000	470	0.59	47	484	0.60	48.40	†3.0
2,000	160,000	940	0.59	47	904	0.56	45.20	-3.8
5,000	400,000	2,350	0.59	47	2,164	0.54	43.28	-7.9
10,000	800,000	4,700	0.59	47	4,264	0.53	42.64	-9.3
50,000	4,000,000	23,500	0.59	47	21,064	0.53	42.13	-10.4

EXCHANGE COMMISSIONS UNDER PRESENT AND PROPOSED RATES

$100 stock

Number of Shares	Value of Trade	Present Rate			Proposed Rate			Percent Change Between Present and Proposed Rates
		Amount	As % of Value	Average Commission Per 100 Shares	Amount	As % of Value	Average Commission Per 100 Shares	
100	$10,000	$49	0.49%	$49	$63	0.68%	$68.00	38.8
200	20,000	98	0.49	49	136	0.68	68.00	38.8
300	30,000	147	0.49	204	0.68	68.00	38.8	
400	40,000	196	0.49	49	272	0.68	68.00	38.8
500	50,000	245	0.49	49	324	0.65	64.80	32.2
1,000	100,000	490	0.49	49	584	0.58	53.40	19.2
2,000	200,000	980	0.49	49	1,104	0.55	55.20	12.6
5,000	500,000	2,450	0.49	49	2,664	0.52	53.28	8.7
10,000	1,000,000	4,900	0.49	49	5,234	0.53	52.64	7.4
50,000	5,000,000	24,500	0.49	49	26,064	0.52	52.13	6.4

LETTER DATED AUGUST 8, 1968

NEW YORK STOCK EXCHANGE
Eleven Wall Street
New York, N.Y. 10005

August 8, 1968

The Honorable Manuel E. Cohen, Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Cohen:

This letter is in reply to your letter of May 28, 1968 in which you requested pursuant to section 19(b) of the Securities Exchange Act that the New York Stock Exchange effect interim changes on or before September 15, 1968 in its minimum rates of commission either (a) in accordance with the revised minimum commission rate schedule attached to the letter, or (b) by eliminating minimum rates of commission with respect to orders in excess of $50,000.

On June 27, 1968, the Board of Governors of the Exchange approved in principle a volume discount, a step-by-step abolition of customer-directed give-ups and a one-third discount to qualified non-member brokers. On August 7, 1968, the Board further considered these questions and now proposes a specific interim non-member commission schedule embodying a reduced rate for volume orders, specific interim intra-member commission schedules embodying across the board reductions, additional language to the Exchange Constitution which would prohibit customer-directed give-ups of work or money in consideration of listed business and a postponement of consideration of non-member access.

Non-Member Schedule

We have carefully considered both of the interim non-member alternatives. We strongly feel that the best interest of the securities industry and the investing public would be served by the maintenance of minimum rates of commission, and therefore we concentrated on alternative (a) rather than alternative (b).

In considering alternative (a), we were particularly concerned with its impact on the public as we noted that it would raise commissions on odd lots in stocks selling at $50 and above and on round-lots up to 400 shares at $52.50 and above, and on round lots of more than 400 shares depending on how much the price exceeded $52.50.

We recognize that the reason alternative (a) raised commissions on certain trades was that you sought to lessen the disparity between the commission rates on high priced and low priced shares. However, we feel this disparity should be dealt with after more study, and that an interim schedule should not involve any increases in rates of commission.

Another of our considerations was the operational difficulties inherent in alternative (a) because of the continuation of an order over nine additional days after the first qualifying trades and the change to a different method of commission computation at the comparatively low breakpoint of 400 shares. Orders above the breakpoint would require special handling not required for orders at or below that point.

We understood that the ten day order was designed to relieve customers and fiduciaries of any conflict in deciding whether to complete an order in one day to minimize the commission chage, or whether to spread it out over more than one day to get better execution prices. However, our research into this question has shown us that in very few instances would the savings in commissions by executing an

order in one day offset the disadvantages of a loss in execution prices of as little as 1/8, the minimum variation on stocks selling above one dollar. We are convinced that price of execution would continue to be the primary consideration in decisions of whether to complete an order in one day.

The operational difficulties involved in your proposed schedule could be reduced to an acceptable minimum by advancing the breakpoint from 400 to 1,000 shares and by limiting the duration of an order, for purposes of calculating a reduced rate of commission, to a single day.

As an alternate to the first of your proposed interim schedules, we propose, for your consideration:

(1) An order is defined as all executions pursuant to a single order for one customer account in one security on one side of the market on one day.

(2) On an order up to and including 1,000 shares, no change from the present schedule.

(3) On that portion of an order above 1,000 shares, the following rates for each round lot:

Price of Stock	*Commission*
$1 -28	0.5% † $4
$28 1/8 - 30	Same as for $28/share
$30 1/8 - 89 7/8	0.5% † $3
$90 and above	0.1% † $39

Minimum $6
Maximum $75

(4) When, on the application of the schedule in paragraphs 2 and 3, the commission would be in excess of $100,000, paragraphs 2 and 3 shall not apply and the minimum commission to be charged shall be $100,000.

As part of our effort to arrive at an appropriate interim schedule, was surveyed our member firms in detail on their orders of over 1,000 shares on March 13 and March 14,

1968. Based on the responses of 306 member firms doing an estimated 93% of all public securities business done on national securities exchanges, the interim schedule proposed above would have resulted in an annual reduction in security commission income of about $150 million, or about 7%.

The implementation of this schedule would involve new order handling procedures on the part of member firms, and reprogramming of computers for those which use data processing equipment to compute commissions. The most time consuming of these would be re-programming, which is estimated to take at least three months. The effective date of the proposed schedule, therefore, would be at least three months after the amendment of the Exchange Constitution.

Intra-Member Rates

In your letter of May 28, 1968, you also asked that intra-member rates be reduced. We feel it would be reasonable as an interim measure to reduce intra-member rates by a percentage similar to the reduction in nonmember commission incomes.

It would be possible to reduce intra-member rates for orders over 1,000 shares, as in our proposed interim nonmember schedule. However, this would limit the effect of the reduction in intra-member rates to a relatively small number of members and member firms. Many member firms both in New York City and across the nation have their trades executed, and sometimes cleared as well, by other members or member firms, and our survey indicates that most of this business is in orders at or under 1,000 shares.

We feel it would be in the best interest of all Exchange member firms to make the lower intra-member rates applicable to all round lot orders. Accordingly, we propose that the reduction in intra-member rates be applied across

the board by lowering the rates per share* in each price bracket by 7% as follows:

Price Per Share	*Rate Per 100 Shares*	
	Floor Brokerage	*Clearance*
Above $ 1 but under $ 2	$1.15	$1.85
Above $ 2 but under $ 5	$1.30	$2.10
Above $ 5 but under $ 10	$1.95	$3.25
Above $ 10 but under $ 20	$2.90	$5.75
Above $ 20 but under $ 40	$3.40	$6.80
Above $ 40 but under $100	$3.60	$7.15
Above $100 but under $150	$4.05	$8.10
Above $150 but under $200	$4.20	$8.40
$200 and over	$4.65	$9.30

Give-Ups

For several years, the Commission has urged the Exchange to prohibit customer-directed give-ups. Your Special Study of the Securities Markets and your Report on Public Policy Implications of Investment Company Growth both found in favor of the industry-wide abolition of customer-directed give-ups. The Commission has urged national securities exchanges to take such action in letters of July 18, 1966 and July 7, 1967. There has been extensive other correspondence from the Commission to this Exchange urging such action. The Commission said most recently in Release #8239 of January 26, 1968, proposing SEC rule 10(b)10: "Approximately 19 months ago, the Commission advised the exchanges of its belief that Exchange rules should be changed to preclude customer-directed give-ups."

The record of the current hearings concerning customer-directed give-ups, and the use made of them lends further support to the Commission's urgings that such give-ups should be prohibited.

In its recommendation on June 27, 1968 the Board of Governors approved in principle a step-by-step prohibition

of customer-directed give-ups, in order to facilitate the adjustment of members and member firms to the changes in the pattern of securities trading which the prohibition is bound to bring about. Further reflection on this point has convinced us that a step-by-step prohibition would not be appropriate. The complex arrangements now existing do not lend themselves to step-by-step diminution, because they involve the use of unrelated trades as a basis for customer-directed give-ups. Thus any but an outright prohibition would result in a continuation of the present give-up practices until the final date for complete prohibition. Further, even if this were practical, in our opinion it would not be proper to permit these practices to continue.

One purpose of an interim schedule is to give the Commission, the Exchange and the customers of securities firms time in which to adjust to possibly new and, as yet, unforseeable trading patterns, and to measure the impact of the interim schedule in light of these changes. It does not appear that the adjustment or the measurement can be accomplished unless the prohibition of customer-directed give-ups becomes effective at the same time as the interim schedule.

While a prohibition of customer-directed give-ups would be effective at the same time as the interim commission schedule, the new schedule would not be effective for at least three months. Securities firms and their customers would have this time in which to adjust to the abolition of customer-directed give-ups.

The testimony at the hearings makes it clear that the prohibition of customer-directed give-ups to be effective must be all inclusive, applying to give-ups by check or by work. It must also apply to trades both related and unrelated to the customer order which originally provides the funds to be given up. We propose that this be accomplished by adding to the first paragraph of Article XV, Section 1 of the Exchange Constitution:

> "No member, member firm or member corporation shall in consideration of the receipt of listed business and at the direct or indirect request of a nonmember or by direct or indirect arrangement with a nonmember make any payments or give up any work or give up all or any part of any commission or other property to which such member, member firm or member corporation is or will be entitled."

As discussed, the Exchange firmly believes that the rule prohibiting customer-directed give-ups must be an integral part of the proposed interim nonmember commission schedule. Any minimum commission schedule, to be effective, must include a prohibition of all customer-directed give-ups.

Nonmember Access

At its June 27 meeting, the Board of Governors also recommended in principle a discount to nonmember brokers of one-third of the nonmember commission. The Board still favors this means of access to the Exchange market. However, because the question of nonmember access cannot be divorced from the question of institutional membership and because both subjects are yet to be taken up at the hearings now being conducted by the Commission, the Exchange is willing to defer action on nonmember broker access at least until those hearings are concluded.

* * *

The proposals in this letter, approved in principle by the Board of Governors of the Exchange at a special meeting yesterday, are the result of much conscientious and diligent effort by all interested parties. It is our strongest hope that the Commission will agree that these proposals will provide the best possible interim solution to the problems facing the securities industry today.

Sincerely,
s/Robert W. Hawk

SPECIAL MEMBERSHIP BULLETIN

NEW YORK STOCK EXCHANGE
Eleven Wall Street
New York, N.Y. 10005

June 27, 1968

TO: Members and Allied Members
SUBJECT: Board Decisions on Volume Discount, Customer-Directed Give-Ups and Nonmember Broker Discount

At its policy meeting today, the Board of Governors decided on three basic elements for a new commission structure. These principles follow—with one significant exception—the proposals we put forward last January 2. Today's Board action was taken on the basis of a report from the Costs and Revenues Committee and after consultation with the advisory groups representing the viewpoints of regional firms and of the Association of Stock Exchange Firms.

The principles are being discussed with the Securities and Exchange Commission as the framework for a new commission schedule. A detailed schedule, as well as several alternates, are already being tested for their potential effect on the current mix of the securities business and on member firm revenues. It is hoped that, sucject to the discussions with the SEC, the new schedule can be proposed during the summer.

Since the three proposals complement one another, the Board believes that final action with respect to each should be taken simultaneously. The three points are as follows:

(1) *The Board of Governors reaffirms its approval of incorporating a volume discount in a new commission schedule.* Such a discount would recognize the lower handling costs of block orders

as compared to smaller transactions. It would also give directly to large investors, mainly institutions, and to the public that has entrusted its savings to the institutions, a reduction in commissions.

At the same time, the schedule we are working on would mitigate disparities that now exist between commission costs for low-priced and high-priced issues.

(2) *Nonmember brokers, both domestic and foreign, who can meet prescribed qualifications would be entitled to a discount of up to one-third from the minimum commission schedule.* We favor amendments to Article XV of the Exchange Constitution to allow qualified non-NYSE brokers to have access to our markets and be compensated directly for their efforts. The additional participation in our market should enhance its depth and liquidity.

Before such a change in our Constitution and Rules can be made, the problem posed by Section 3(a)(3) of the Securities Exchange Act of 1934 would have to be resolved. That provision defines a "member" as a person who is permitted to make use of the facilities of the Exchange for transactions thereon "with the payment of a commission or fee which is less than that charged the general public." Because of the obligations the Act places on the Exchange to police ***

As you know, SEC investigative hearings on the commission structure and related matters begin in Washington next week. Give-ups and reciprocal practices are among the topics the SEC intends to examine. Fortunately, the Exchange's formulation of policy on these matters began long before the scheduling of the present hearings. With the principles defined for restructuring commissions, and a new schedule near completion, the Exchange is in a solid posture.

The three policy decisions reached by the Board today, coupled with the commission schedule to follow, speak directly to the changing nature of the securities market and the questions raised by the SEC and the Justice Department, they embody a totally modernized approach to the way the membership charges for its services, parallel in spirit to the automation and other up-to-date techniques that have been introduced recently into such aspects of our business as market data communications, odd-lot handling, and clearance and delivery of securities.

A new commission structure along the lines of the three policy decisions reported above is bound to involve an overall decrease in member firm income on a given volume of business.

The Exchange is making detailed calculations of the economic effects of the possible commission changes on member firms, based on careful sampling studies and examination of Income and Expense reports. When the final commission schedule is developed, we will be in position to estimate its total costs and the effects on different types of firms, varying, of course, with the nature of each firm's commission business.

It should be noted that the "interim" commission schedule proposed May 28 by the SEC, which was figured on the 1966 Public Transaction Study, involved a reduction of approximately $110 million in gross member firm revenues. The reduction could be much greater on the basis of the membership's current volume and mix of business, and if allowance is made for revenue losses resulting from a discount to qualified nonmember brokers.

The need to restructure commissions comes at a time when the securities industry, which is characteristically cyclical in its level of activity, is at an all-time peak in volume of business. The industry is incurring heavy costs to gear itself for handling this volume. The best prospect for our membership to recover the immediate costs of a

restructuring of commissions lies in fostering long-term growth in demand for the membership's services to the investing public.

The principles approved by the Board, and the commission schedule being prepared to carry them out, will encourage such long-term growth. In the long run, these changes may well present member firms an opportunity to attract additional business to the Exchange from nonmember brokers in this country and abroad, improving the position of the Exchange and its members. Such additional business would add to the depth and liquidity of Exchange markets, thus enabling the Exchange marketplace to do a better job for all investors who use it.

We will, of course, keep you informed of developments and hope before long to be able to submit, for a vote of the membership, a full commission schedule and related Constitutional amendments.

s/ Robert W. Haack

LETTER DATED AUGUST 30, 1968

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, N.Y. 10005

Dear Mr. Haack:

We have received your letters of August 8 and 20, 1968 responding to our letter of May 28, 1968 in which the Commission requested pursuant to Section 19(b) of the Securities Exchange Act of 1934 that the New York Stock Exchange effect changes, to become effective on or before September 15, 1968, in its rules, policies and practices in respect of its commission rate by modifying Article XV, Section 2(a)(1) and appropriate other sections of the Exchange constitution and rules either (a) in accordance with revised minimum commission rates as set forth in an attachment to our letter or alternatively, (b) by eliminating, with respect to orders in excess of $50,000, requirements for minimum rates of commission. We also stated in our May 28 letter that the Exchange should implement appropriate reductions in the current intra-member rate for non-executing firms or eliminate requirements for minimum intra-member charges to such non-executing firms.

Your letters of August 8 and 20, 1968 indicate that pursuant to our Section 19(b) request the Board of Governors now is proposing "a specific interim non-member commission schedule embodying a reduced note for volume orders." We note that you have chosen to proceed with a revised minimum commission rate schedule rather than with alternative (b) stated in the Commission's letter of May 28. In addition, the Board is proposing a specified interim intra-member reduced commission schedule. The Board's proposal includes the following new

language to be added to Section 1 of Paragraph 1701 of the Exchange constitution:

> "No member, member firm or member corporation shall, in consideration of the receipt of listed business and at the direct or indirect request of a nonmember or by direct or indirect arrangement with a nonmember, make any payment or give up any work or give up all or any part of any commission or other property to which such member, member firm or member corporation is or will be entitled."

Your letter of August 8 states that the change in Paragraph 1701 would ". . . prohibit customer-directed give-ups of work or money in consideration of listed business . . . " We understand that this change is intended to prohibit all forms of customer-directed give-ups, but is not meant to preclude or interfere with non-customer directed inter-dealer reciprocal business on regional exchanges nor is it designed to prevent the procedures whereby broker-dealer affiliates of institutions may credit or return commissions to institutions with which they are affiliates.

In view of the considerations set forth in your letters of August 8 and 20 and subject to confirmation of the understanding stated in the preceding paragraph of this letter, we hereby modify the direction to you, pursuant to Section 19(b) of the Exchange Act contained in the Commission's letter of May 28, 1968 to the effect that: alternative (a) of such direction will be satisfied by the adoption of the specific interim non-member commission schedule described in your letters of August 8 and 20, the specific interim intra-member commission schedule also described therein, and the additional language to the Exchange constitution prohibiting customer-directed give-ups. Alternative (b) of the Commission's May 28, 1968 direction to your Exchange remains unmodified should

your members elect not to adopt alternative (a) as so modified.

We wish to emphasize that these changes are interim steps. The Commission has reached no conclusion on whether the particular rates embodied in the interim non-member commission schedule (described in your letters of August 8 and 20) reflect the optimum form of rate structure for your Exchange or that any schedule of specific rates would provide a complete answer to the problems raised in Release No. 8239 and the comments thereon. Additional measures with respect to these and other matters are under continuing consideration and will be examined further in the course of our hearings. In directing you to adopt these measures on an interim basis we assume that you will address yourself as promptly as possible to the matter of changes of a permanent nature.

Sincerely,
Manuel F. Cohen
Chairman

THE URGENCY FOR AN IMMEDIATE COMMISSION INCREASE

(Statement by Mr. Robert W. Haack
Securities & Exchange Commission, February 13, 1970)

Introduction

Four of every ten NYSE member firms doing a public business lost money on security commission income (including net margin interest income) in the first half of 1969. Their cumulative loss amounted to $58 million. Losses ranged up to $5.7 million, with 13 firms losing over $1 million and 51 losing over $250,000. The profit squeeze reflects the industry's attempts to continue to upgrade and modernize operations in the face of a drop in income and sharply rising costs. Prices paid by the industry for the goods and services it buys rose an estimated 6% last year alone, and close to 60% since the last commission rate hike in 1958.

In the fact of these financial results, it takes little imagination to foresee that member firms in their effort to minimize losses will have no recourse but to trim the quality of their services to customers, unless revenue relief is forthcoming. Even more adverse to the interests of the investor and to confidence in the securities markets would be the repercussions resulting from financial failure.

Despite their precarious profit situation, NYSE member firms as yet have hesitated to take cost-pruning steps where the effect would be to impair their ability to handle future volume increases. Very much in their minds has also been the risk of a repetition of the 1968 paperwork situation. At present, automation expenditures among NYSE firms are running at a $100 million annual rate. By the end of this decade, they are expected to be approaching $800 million a year. In 1969, employment associated with security commission income continued to rise despite declining income and profits. Non-sales employment was 84,000 at

mid-year, some 5,000 greater han at year-end 1968.

However, even a pickup in volume is not likely to produce reasonable profit levels for a substantial number of member firms with relatively low revenues per ticket. This is indicated by our data on transaction revenues. For example, firms which suffered losses in January-June 1969, would have to increase their aggregate SCI 14% merely to break even—and this allows for no related increases in costs other than sales commissions, floor brokerage and clearance charges. Only a fraction of the income shortfall could be attributed to the 3% dip in average daily volume between 1968 and the first half of 1969. Even if volume had been sustained at the 1968 level, an income increase of 10.5% would have been required to pull the loss firms up to the break-even point.

Return on Capital

The $80.1 million pre-tax profit earned on SCI in the first half of 1969 translated into the equivalent of a 3.5% *annual* after-tax return on capital, and even this depressed rate was due to net margin interest income rather than to security commission profits. On the basis of available data for the latter half of 1969, the actual return for the year is even lower.

The poor profit performance can be better appreciated in the perspective of recent historical experience in American industry generally. Analysis of a group of 51 industries representing virtually the whole range of American enterprise indicates an average five-year after-tax return on capital (1964-68) of 12%. (By far the lowest return was for railroads, 4.7%.) Only a quarter of all industries had returns of under 9.8%.

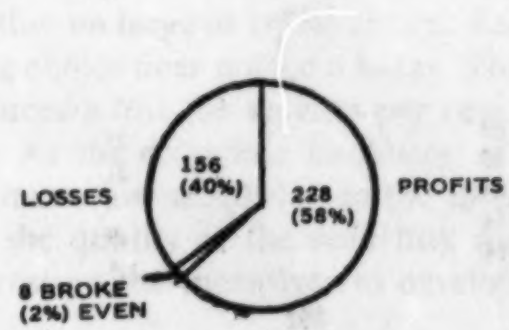
Because of the risks in the securities business, a more valid comparison is the return on security commissions with returns in industries in the upper earnings range. As is generally acknowledged, the greater the volatility of annual

profits the greater the return necessary to compensate for these risks. Capital will not flow to risk enterprises unless adequately compensated. 'Analysis of five-year average return on capital shows an upper quartile return of 12.8%. About one-sixth of that group experienced returns in excess of 15%. Two industries experienced returns in excess of 20%—toiletries and cosmetics (24.4%) and mobile homes (21.2%).

Distribution of Return on Capital — 1969

The average 3.5% after-tax return on SCI capital in the first half of 1969 understates the urgency of a sizeable segment of the industry for quick rate relief. Of 392 firms analyzed, 186 lost money on their security commission income (including net margin interest income) and eight broke even. Losing firms accounted for 37% of security commission income. (If all lines of business are considered, 117 firms suffered losses—about one-third of member firms doing a public business)

NYSE MEMBER FIRMS WITH PROFITS OR LOSSES
1st HALF 1969



Among the 156 firms that experienced losses on SCI income in 1969, fully one-quarter had losses equivalent to over 25% of capital and over one-third had losses in the 11% to 25% range.

Among the 228 firms with SCI profits, about one in four had after-tax profits in excess of 15%, while about one in three had after-tax profits of .5% or less.

Taking all 392 firms together, the proportion with after-tax returns in excess of 15% was only one out of six. At the other end of the scale, the proportion of all firms with losses on their capital in excess of 15% was one out of five. One out of ten firms experienced losses of more than 25% on their invested capital. Obviously, such monumental losses cannot be sustained by any industry for very long.

LOSS OR AFTER-TAX RETURN ON CAPITAL
FIRST-HALF 1969 AT ANNUAL RATES

Profit or Loss Rate	Number of Firms		Proportion of Total Firms	
(Per cent)			(Per cent)	
Losses				
51% & over	14		4%	
-26—50	25		7	
-16—25	32		8	
-6—15	44		11	
-1—5	41		10	
Total, loss firms		156		40%
Broke even		8		2%
Profits				
1—5	83		21	
6—15	83		21	
16—25	34		8	
26—50	14		4	
51% & over	14		4	
Total, all firms		392		100%

Profitability and Ticket Size

A major factor contributing to profitability, or lack of it, is commission earned per ticket. This shows up clearly in first-half 1969 income and expense data. Firms with pre-tax profits on SCI grossed an average of $56 per transaction, 1.4 times larger than the $40 average for all firms with losses. Particularly striking are the extremes in ticket size among the most profitable firms and those with the largest rates of loss. The ten firms with the largest pre-tax profits as a per cent of SCI (excluding margin interest income) averaged $512 in commissions per transaction. This compares with only a $31 average for the ten firms with the largest relative losses. It is clear that major losses were centered in firms writing the smaller, most frequent types or orders.

In all, 155 firms had commissions per transaction below the $39.69 average for all loss firms. Of that total, seven in ten suffered losses. Conversely, 106 firms had commissions per ticket in excess of the $56.12 average for all profitable firms. Of those, seven in ten made a profit.

These results underline the critical need for prompt enactment of a rate structure which will not only increase overall revenues, but restore balance to the commission schedule—enabling firms to earn a fair rate of profit no matter where they choose to concentrate their commission business, whether on large or small orders. For most firms, that marketing choice does not exist today. The small order business produces a loss for seventy per cent of the firms engaged in it. As the economic backbone of a major industry, the commission schedule—in the interests of both investors and the quality of the securities markets themselves—must restore the incentives to develop and service *all* orders.

Member Firm Profitability—Third Quarter

Unfortunately, industry-wide income and expense data are not available beyond the first-half of 1969. However, limited data for the third-quarter are available from Wright Associates, a management consulting firm that does continuing financial analyses for a number of NYSE member firms.

The data from Wright Associates offer evidence of further deterioration in the industry's bleak profit picture in the third-quarter of 1969. The 16 firms reporting to Wright Associates, together accounting for 22.6% of NYSE business in the third quarter, had operating *losses* equivalent to 15% of total income, but before reserves, interest on capital and income taxes. In other words, the simple firms, in effect, paid a subsidy of 15 cents on the revenue dollar for the privilege of serving their customers. Since Wright Associates data are for *total* income, they probably understate the size of SCI losses and overstate the size of SCI profits.

The third quarter loss virtually wiped out the modest *total* operating profits that the 16 firms made in the first and second quarters — respectively, 8.5% and 5.9%. For the first nine months of 1969, profits for this group of large member firms was a miniscule 1.1% of gross income (before reserves, interest on capital and income taxes).

Among the 16 sample firms, only one turned a profit in the third quarter and the median firm had a 14.1% loss on gross income. The largest losses were 23.3%, 32.1%, 53.2%, and 61.5%.

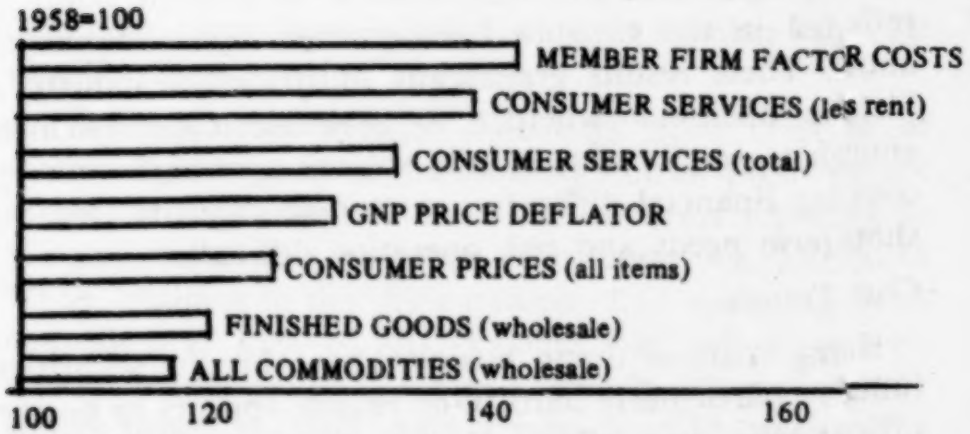
The sample firms' poor 1969 profit performance reflects a relatively rapid increase in break-even points, as firms continued to add to capacity in the face of flagging volume. For example, average daily third-quarter 1969 NYSE volume was off about 5% from the year earlier figure. to 11.4 million shares a day. Over the same period, average break-even NYSE volume for the firms in the Wright Associates sample rose 32%, to 12.7 million shares daily.

Thus, what would have been a profitable volume level for the sample firms a year earlier—11.4 million shares traded daily on the NYSE against a break-even point of 9.6 million shares—was completely inadequate in 1969. The gap between the 11.4 million average daily shares traded in the third quarter and the 12.7 million break-even point is reflected in the sizeable third-quarter losses, discussed above. These results graphically illustrate the industry's historic dilemma—whether to maintain capacity high enough to comfortably handle volume upswings, thereby courting financial difficulty, or to hold capacity close to short-term needs and risk operating difficulties.

Cost Trends

Rising costs of doing business have hit the securities industry particularly hard. One reason appears to be the office boom, especially in New York City, which has intensified competition for space, employees and services. Over the period 1958-69,, the weighted average of costs of goods and services purchased by NYSE member firms rose an estimated 59%. This is 4.8 times the increase in the Wholesale Price Index and about 2.2 times that in the overall Consumer Price Index. It is also well above the much publicized climb in the service component of the Consumer Price Index (44%) over the 1958-69 period.

CHANGES IN SELECTED PRICE INDEXES 1958-69



SOURCES: Depts. of Labor & Commerce. Index of member firm costs developed by the NYSE.

A key factor in the strong rise in member firm unit costs is the wage bill. Rates for clerical workers rose, on average, 59% between 1958 and 1969. And this does not include allowance for the widespread introduction—under competitive labor market conditions—of new, and improvements in existing, employee benefit programs (a $150 million item in 1969). Manufacturing basic wage rates, by comparison, averaged a 49% increase.

The price of 100 square feet of rental space in 1958, purchased only 52 square feet of space in 1969. Similarly, a dollar spent on advertising in 1969 bought only 50% as much advertising as it did in 1958. The industry's extensive communication network cost 50% more to maintain than a comparable network would have cost in 1968. Comparisons of this type can be made for virtually the entire gamut of goods and services purchased by NYSE member firms, as indicated in the table below.

1969 PURCHASES OF GOODS AND SERVICES BY NYSE MEMBER FIRMS IN 1968 PRICES

Cost Items	*Estimated 1969 Expenses #* (Millions)*	*% Increase in Unit Costs 1958/1969*	*1969 Expenses in 1958 Prices (Millions)*
Professional Fees	$ 83.2	79%	$ 46.5
Market Information Services	44.0	87	23.5
Subscription to Periodicals	27.9	65	16.9
Telephone and Telegraph	150.0	50	100.0
Advertising and Sales Literature	65.5	82	36.0
Entertainment and Travel	70.0	40	50.0
Equipment Rental	81.1	-1	81.9
Postage, Stationery and Office Supplies	128.7	61	79.9
Clerical and Administrative Salaries	1,234.8	59	776.6
Other Employee Benefits	150.2	67	89.9
Rent, Heat, Light, etc.	144.2	91	75.5
Leased Wires	38.5	75	22.0
Tickers and Projectors	26.7	85	14.4
Total	$2,244.8		$1,413.1

WEIGHTED 1969 INDEX OF PRICES PAID BY MEMBER FIRMS, (1958 = 100) — *159.*

 # 1969 expenses are annualized first-half data.

*** Data exclude local tax costs since the complete restructuring of New York City taxes in 1966 makes comparisons with prior years impossible. Its basic thrust, however, was to raise the tax burden.**

Data also exclude interest costs.

Sources: **Budget data from member firm income and expense reports.**

The lone exception is equipment rental, for which prices fell 1%. For many firms, however, the decline is illusory. It reflects adjustment for quality improvements in equipment, particularly computers—not lower actual costs per unit.

Commission Rates Versus Other Changes—1958-1969

Over the years since the last commission rate adjustment, the seemingly inexorable rise in prices of other services has received prominent monthly attention in all the media. The 49% increase in the services component (excluding rent) of the Consumer Price Index since 1958 is well known. Insurance and finance costs, alone, have risen by over one-third *since the end of 1965.* Over the same four-year span housekeeping and home maintenance expenses were up about one-third. Two trips to the family doctor or to the barber today cost more than three trips did in 1958.

A current vivid example of how business costs have been pushing against income is the discernible trend among real estate brokers to boost their commission rates—despite soaring home prices, upon which the rates are based. The securities industry has had no such cushion to fall back on. Stock splits serve to hold the average price per share down, so commissions on any given size order benefit relatively little from the long-term rise in stock prices—and in bad market years actually declines.

This is illustrated in the following table which shows the commission on a 100 share order traded at the average NYSE round-lot price for the designated year.

INCOME PER 100 SHARE TRADE BASED ON THE AVERAGE ROUND-LOT PRICE PER SHARE

Year	*Average Price Per 100 Shares*	*Commission**
1958	3,390	35.95
1959	3,980	38.90
1960	3,700	37.50
1961	3,870	38.35
1962	3,800	38.00
1963	3,910	38.55
1964	3,900	38.50
1965	3,920	38.60
1966	4,360	40.80
1967	4,250	40.25
1968	4,320	40.60
1969	4,040	39.20

* 0.5% of value plus $19.

Because of the relative stability of revenue on any given size order, it becomes increasingly difficult to break-even—much less to make a profit—on smaller orders. While it is true that the size of securities orders have trended upward, by far the bulk of orders continue to be for 100 shares or less. (While orders of 100 shares or less account for 70% of all orders, they account for only 21% of shares traded.) Since the larger, more profitable orders are not evenly distributed among member firms, the increase in average ticket size does relatively little to help those firms with a large retail business.

For example, taking all markets together (NYSE, Amex, O-T-C and regionals) the average commission per 100 share order in the first half of 1969 was $30.79. This was less than half the average for all orders, $63.13. Among the 16 large firms for which detailed data are available (23% of

NYSE business), average commissions per transaction for all except two came closer to the lower figure than the higher. The average commission was $42.60 and the range was from $37.63 to $50.51.

COMMISSION PER
SECURITY AGENCY TRANSACTION
16 LARGE RETAIL FIRMS
FIRST HALF 1969

irm	Commission*	Firm	*Average* Commission*
1	$37.63	9	$42.76
2	38.18	10	43.14
3	38.30	11	43.84
4	39.49	12	45.21
5	40.22	13	45.43
6	40.49	14	45.48
7	40.69	15	49.19
8	41.12	16	50.51

For all NYSE member firms that had a loss on SCI business (before margin interest adjustment), the average commission earned on all transactions was $39.69.

What If Commission Rates Moved in Step with General Price Averages?

The industry's financial plight in 1969 reflects in part, at least, the squeeze between the relatively rapid rise in member firm costs and the stability of its rate schedule.

If commission rates had drifted up each year since 1958 in step with the overall increase in the prices of consumer services (excluding rent), the relatively small annual increments would have lifted the average commission on a 100 share order on the NYSE in 1969 to $53—about 50% higher than the actual $35.45 average. How this series of changes, each small in itself, would have mounted over the 1958-69 period is illustrated in the following table.

AVERAGE COMMISSION ON 100 SHARE ORDER OF NYSE STOCK
IN 1969 IN RATES INCREASED IN STEP WITH THE CONSUMER PRICE INDEX
FOR SERVICES [EXCLUDING RENT]

1958	$35.45
1959	36.66
1960	38.07
1961	39.00
1962	40.01
1963	40.59
1964	41.48
1965	42.54
1966	44.31
1967	46.47
1968	49.13
1969	52.89
1969 (actual first-half average)	35.45

Sources: Rates of increase based on the Consumer Price Index as reported in the following: *Economic Report of the President,* 1969 (p. 279) and *Economic Indicators,* December 1969 (p. 20).

Conclusion

Fragmentary reports of securities firms' third-quarter and fourth-quarter operating results, together with industry-wide data on first-half performance, sketch a dark financial picture of the securities industry. They emphasize the need for quick action on initiating a new commission rate schedule if the meatsxe approach to economizing is to be forestalled.

At stake is no less than the industry's financial health, upon which rests its ability to meet efficiently long-term demands of both individual and institutional investors.

NEW YORK STOCK EXCHANGE
Eleven Wall Street
New York, N.Y. 10005

Robert W. Haack
President

TO: Members and Allied Members March 19, 1970

SUBJECT: *Interim Service Charge*

The Board of Governors today approved in principle an interim measure to relieve the cost pressures on the securities industry of handling commission business, particularly for smaller orders.

The plan provides for instituting a service charge equal to not less than the lesser of $15 or 50 per cent of the required minimum commission. A copy of the proposed rule and a table showing examples of the effect on typical orders are enclosed.

Although firms should be aware that since this is a minimum service charge, the Exchange Constitution does not permit the charge to be shared in the form of compensation to member firm registered representatives, we would remind firms that they may continue to follow their individual policies in sharing the minimum commission with their sales personnel.

The charge would be imposed by means of a rule of the Stock Exchange which now goes to the Securities and Exchange Commission for their comments. Allowing for the normal three-week waiting period for SEC comments, if the Commission interposes no objection, the new charge could be given final approval by our Board on April 12 and take effect shortly thereafter. However, we have asked the SEC to expedite their review in order that we might have their comments in less than three weeks.

It is evident that this interim charge is not a broad revision of the commission structure, such as outlined by our consultants, National Economic Research Associates, in

the proposal filed with the SEC February 13. However, the SEC staff has indicated that it may be many months before it can complete its review of the NSRA proposals for a basic restructuring of commission rates. Meanwhile, the industry urgently requires immediate interim relief. The $15 charge, with its 50 per cent limitation, would accomplish this objective by increasing gross commission income of member organizations by an estimated 18 per cent (if applied to gross revenues for the first half of 1969). This is approximately the same size as the increase for all markets as recommended in the NERA proposal.

Chairman Lasker, Vice Chairman DeNunzio and I have told the Commission that we believe this charge is the minimum necessary to restore some measure of financial health to the securities commission business. While it will not be sufficient to make small orders fully remunerative, it will allow some of the financial relief necessary for member firm organizations during the period immediately ahead. We believe that this proposal has several important advantages to recommend it:

(1) The order charges would flow primarily to those firms most in need of relief.

(2) The plan keeps the increases paid on small orders to a bare minimum, both by limiting the aggregate dollars requested and by accepting the 50 per cent ceiling. The NEPA schedule would increase commission rates on orders up to 399 shares by a total of $660 million if applied by all NYSE member firms to agency trades in all markets. Our interim charge would yield increases only *two-thirds* as great, less than $450 million.

(3) The public is protected by the fact that the net amount of the interim relief is not substantially different from the aggregate ultimate relief proposed by NERA on a net basis.

(4) The interim charge would tend to move overall brokerage charges more closely in line with the costs of servicing those orders. Thus we believe that this step will begin to bring rates in the direction of a more balanced and more equitable structure.

(5) The 50 per cent ceiling on any rate increase mitigates the impact of the higher charges needed by member firms on small orders, especially odd-lot trades. With a heavy toll of inflation since 1958, when rates were last changed, there should be little justifiable opposition to a realignment of charges which limit the increase to a 50 per cent maximum. The imposition of the 50 per cent ceiling makes it necessary to spread some of the needed increases among other size orders, which accounts for the fact that we are now recommending an interim increase in rates on all orders up to and including 1,000 shares.

(6) This proposal would allow member firms to meet the costs of their retail orders but it would not necessarily make these profitable. Because the proposed interim charge would provide only partial relief, and because it would still not assure a positive return on capital for firms in the retail end of the business, we would hope that this interim adjustment would be replaced by a more permanent and more sufficient commission rate schedule before long.

(7) Another feature which recommends the interim proposal is its simplicity. It should be easy for the public to understand an order charge such as we are proposing. We believe this proposal also has merit from an operations standpoint in that firms at present must account separately for orders in excess of 1,000 shares.

The interim charge was recommended unanimously by the Costs and Revenues Committee and voted unanimously by the Board of Governors. A wide segment of our industry

has been acquainted with the plan at special meetings this week and there has been no opposition in any quarter.

I think you will agree that on an emergency basis this interim charge will help the industry to recover more of the costs of serving the small investor. This should provide substantial encouragement to firms to maintain and increase their service to the small investor whose continued participation is essential to the liquidity of the central market.

s1Robert W. Haack

Proposed Rule 383 on Service Charge

In addition to the commission computed in accordance with the provisions of paragraph 2(a)(1) of the Constitution, each member organization shall charge and collect upon the execution on the Floor of the Exchange of any order for the purchase or sale for the account of a non-member or an allied member of 1,000 shares or less a service charge equal to not less than the lesser of $15 or 50% of such commission. For the purposes of this Rule, an order shall be deemed to include all purchases or sales for one account of round lots or odd lots or both of a single security, on the same day, pursuant to a single order.

COMMISSIONS PLUS PROPOSED SERVICE CHARGE

Shares Per Order	Prior $10	$20	$40	$75	$100	$150
20	$9.00	$13.50	$19.50	$30.00	$37.50	$22.50
50	15.00	22.50	37.50	50.75	57.00	44.25
100	25.50	40.50	57.00	61.50	64.00	59.00
200	49.00	69.00	93.00	108.00	113.00	103.00
500	100.00	150.00	210.00	247.50	260.00	235.00
800	151.00	231.00	327.00	387.00	407.00	367.00
1,000	185.00	285.00	405.00	480.00	505.00	455.00
Over 1,000			No Change			

PER CENT CHANGE OVER PRESENT COMMISSIONS

Shares Per Order	Prior $10	$20	$40	$75	$100	$150
20	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
50	50.0	50.0	50.0	42.0	35.7	50.0
100	50.0	50.0	38.5	32.3	30.6	34.1
200	44.1	27.8	19.2	16.1	15.3	17.0
500	17.6	11.1	7.7	6.5	6.1	6.8
800	11.0	6.9	4.8	4.0	3.8	4.3
1,000	8.8	5.6	3.8	3.2	3.1	3.4
Over 1,000			No Change			

LETTER DATED APRIL 2, 1970

The following letter was dictated by Shelley Rappaport of the SEC on 4/2/70:

April 2, 1970

Mr. Robert W. Haack, President
New York Stock Exchange
11 Wall Street
New York, New York 10005

Dear Mr. Haack:

In your letter of March 19, 1970 your submitted for our review pursuant to Securities Exchange Act Rule 17a-8, a proposed rule which would require member organizations to impose a surcharge in the form of a service fee of $15 or 50% of the applicable commission, whichever is the lesser, on orders of 1,000 shares or less. The Exchange states that this service charge is needed to give interim financial relief to the indsutry while the Commission considers the proposals for longer term revisions in the existing rate structure submitted by the Exchange on February 13, 1970.

In support of the proposed interim increase, the Exchange represents that a large number of its member organizations which do a public business sustained substantial losses in 1969 and that the situation has further deteriorated during the first quarter of 1970. Data obtained by the Commission confirms the loss experience of these firms. Past losses and the propsect of a continued financial drain have influenced many firms to impose limitations on their service to small investors. Based on studies prepared by the National Economic Research Associates, Inc. as supplemented by more recent samplings of member organizations, the Exchange estimates that a surcharge of $15 limited to 50% is required to provide adequate brokerage services for small investors and to retain needed capital within the securities business.

The Commission is aware of the contribution of small investors to the depth and liquidity of our trading markets and considers it to be vital to the public interest that such investors continue to be able to participate directly in equity investment. We are concerned with the financial problem of the industry and the losses sustained in the past year and during the first quarter of 1970. Accordingly, we will not object to the Exchange imposing an interim surcharge on rates to provide emergency financial relief while more fundamental alterations of the existing rate structure can be considered. However, we believe such action can be viewed as justifiable only if the service fee is to be imposed for a 90-day period only and will expire thereafter. This self-liquidating factor would assure that the increase will, in fact, be an interim measure. Its continuance for more than one quarter will require a review of the economic conditions, including transaction volume levels, existing at that future time.

The Commission expressly predicates its non-objection to the interim increase in charges upon its expectation that the Exchange will take all steps necessary to assure that full brokerage services for small investors are restored and that transaction size and other limitations on such accounts imposed in the last year by the Exchange's membership will be removed. We also expect that the Exchange will undertake to make certain that the additional revenues produced by the interim surcharge will be received by the member firm obtaining the customer's order, and will be prudently employed by its member organization to improve their operations and financial position.

Lastly, we wish to emphasize that the Commission's action is based on our understanding that immediate financial relief is required. Our study of the existing commission rate structure will continue and we shall also monitor the operation of the interim fee arrangement. A full examination of the proposals for longer term revisions

in the rate structure will be made as expeditiously as possible. In this regard, the Commission expects that the Exchange will promptly comply with our request to make available all underlying data and materials required for such review.

Sincerely,
s/Hamer H. Budge, Chairman
Securities & Exchange Commission

For RELEASE Thursday, July 2, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 8923

The Securities and Exchange Commission today announced that its commission rate hearings would be reconvened July 13 and continue, if necessary, for the remainder of that week to receive submissions of evidence pertinent to the question whether it is necessary or appropriate in the public interest and to insure public investors adequate access to the securities markets, to extend for some further period of time the interim service charge provided in New York Stock Exchange Rule 383 and related rules of other exchanges. Pending action of the Commission in response to such hearings the Commission will not take action to prevent the temporary continuation by the exchanges of such service charges.

The Commission had anticipated initially that the service charge would expire on July 6 and that further extensions of it would be unnecessary.[1] The New York Stock Exchange has submitted a request for extension, which was reprinted in the Commission's Release 34-8914. On June 30, 1970, the Exchange made its submission of data in support of the service charge extension, a copy of which is included herein. The New York Stock Exchange also submitted on June 30, a proposed new minimum commission rate schedule which is intended, if adopted, to

1. See the Commission's Release 34-8860 of April 2, 1970. The service charge provides that transactions executed on one day pursuant to a single order in a security shall be subject, in addition to the applicable minimum commission, to a service charge of the lesser of $15 or 50% of such minimum commission and that transaction size and other limitations or small orders imposed by member firms are suspended while the service charge is in effect.

supplant the existing commission rate schedule as well as the service charge.

In permitting the service charge to continue until the Commission has an opportunity to consider the proposals and comments, the Commission imposed the same terms and conditions which it had initially required including the removal of all restrictions by member firms on transactions by small investors.

The hearing will be reconvened at 10:00 a.m. on July 13 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549. The Commission has requested the New York Stock Exchange to appear on that date to submit testimony and relevant data concerning its request for an extension of the interim service charge. The Commission invites interested persons, including the other exchanges, to submit their views and requests any persons who may wish to present testimony to file appropriate summaries of their presentations with the Secretary of the Commission not later than July 10, 1970.

The New York Stock Exchange submission of data in support of the service charge extension follows:

June 29, 1970

The Honorable Hamer H. Budge
Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Mr. Chairman:

In my letter of June 18th, I promised to provide the Commission with more recent statistics, specifically May data, on the effect of the service charge on member firm profitability. We have now completed this analysis. The attached report provides not only more current information but it includes an allocation of profit and loss to the securities commission business. It also analyzes the effect

of the service charge on the profitability of three broad categories of firms: Retail firms, defined as those with average size transactions between 1 and 399 shares; diversified firms with average trades between 400-999; and institutional firms with an average of 1,000 shares and more.

The overall profitability of member firms has deteriorated markedly. During the last quarter of 1969, about two-thirds of all firms were in the black. By contrast, in the months of April and May, 1970, two-thirds were showing losses. Not only were fewer firms in the profit column, but the dollar amount of profits shrank dramatically. During the fourth quarter of 1969, the firms in our sample—accounting for two-thirds of the industry—earned a net profit of $88.6 million. In the most recent months of April and May, these firms *lost* $28.7 million and $20.6 million. I should point out that these losses were incurred despite the fact that our volume averaged 10.1 million shares per day in April and 12.3 million in May.

The report shows the importance of the service charge, particularly to firms specializing in retail orders. For these firms, the service charge produced $8.4 million in April and $16.2 million in May. Has it not been for the service charge, their losses on commission business would have mounted in April from $23.4 million to $31.9 million, and in May from $9.9 million to $26.1 million. I might add that the retail firms received over 90 percent of the revenues generated by the service charge.

As you know, the service charge has not produced the income expected of it. At the level of volume in April and May, the service charge provided only two-thirds of its anticipated revenue. But even if all of it had been realized, the firms would have had a hard time breaking even. Our statistics indicate that the actual cost to the public has averaged less than $10 per order because of the 50% maximum limitation.

On the basis of the attached analysis, it is clear that the service charge, though inadequate, is an essential interim measure and we renew our request for its extension.

Sincerely,

Robert W. Haack

THE EFFECT OF THE SERVICE CHARGE ON MEMBER FIRM PROFITABILITY

Introduction

The interim service charge was implemented to provide financial relief to firms doing a securities commission business with the public. It was an amergency measure designed to restore some degree of financial health to the securities commission business. Its continuation today is as urgent as ever. In the first quarter of this year, retail firms suffered twice the losses on their securities commission business incurred in the final quarter of 1969. Even with the service charge, the monthly losses in April-May were larger than in the last quarter of 1969. Declining volume and stock prices have caused revenues to fall off more rapidly than costs. In addition, the severe erosion in stock volume has meant that revenues generated from the service charge have fallen far short of expectations.

The SEC and NYSE staffs agreed to procedures for monitoring the effects of the service charge. Specifically, it was agreed that detailed data would be gathered for 77 firms (including the 50 largest) accounting for 69 percent of member firms' gross income in 1969. These figures permit an extensive analysis of the financial situation of firms doing a public commission business. At this time, complete information has been processed for 74 of the 77 firms for the period from the fourth quarter of 1969 to May, 1970. The 74 firms accounted for 67 percent of the industry's total gross revenue and 65 percent of its security commission income in 1969.

The overall profitability of member firms has deteriorated markedly from the end of 1969 through the spring of 1970. Around two-thirds of the firms in the sample were operating at a profitable level during the last quarter of 1969. In the months of April and May, 1970, two-thirds were showing losses. In other words, one-third of the firms under study have gone from operating in the *black* to running in the *red* between the latter part of 1969 and the spring of 1970.

Not only were there progressively fewer firms in the black, but there has been a steady shrinkage in the dollar amount of their profits. During the fourth quarter of 1969, the firms in the sample earned a net profit of $88.6 million; in the first quarter of 1970, $20.2 million; and in the months of April and May, they *lost* $28.7 million and $20.6 million, respectively. It may be more instructive to consider these figures on an annual basis. (This also permits a direct comparison of quarterly and monthly figures.) If the fourth quarter 1969 profits were projected for a full year, these firms would have earned $354.2 million. The first quarter profits annualized come to $80.8 million. A sharp contrast is provided by the most recent data. The April and May *deficits* annualized come to $344.5 million and $247.2 million, respectively.

Due to the heterogeneity of the NYSE membership in terms of business mix and clientele, the overall figures disguise important underlying trends. For this reason, it may be more meaningful to classify the firms according to their type of business. We therefore separated the firms in our sample into three groups on the basis of their average shares per order in 1969. Retail firms, defined as those with average size transactions between 1 and 399 shares; a middle group of diversified firms with average trades between 400 and 999 shares; and institutional firms with an average of 1,000 shares and more.

The service charge was designed to have its greatest

impact on the retail firms. The following discussion therefore begins with this group and considers their overall profitability as well as their profits and losses on securities commission business only. The profitability of the securities commission business was obtained by asking each firm for its securities commission income and by allocating each line of expense according to the firm's 1969 I & E proportions.

Retail Firm—Securities Commission Income (SCI).

The security commission business has remained an unprofitable activity for the 54 firms included in the retail category. In the last quarter of 1969, less than one-third of these firms earned any profit on their SCI activity. During the first quarter of 1970, and in the month of April, about 80% of the retail houses lost money on their public commission business. The May figures look somewhat less dismal, both because volume was above 12 million shares per day and the service charge was collected for the full month. Yet, over 57 percent of the group suffered deficits on SCI business. Had the service charge not been in effect during May, 82 percent of the firms, instead of 57 percent, would have lost money on their commission business.

The dollar amounts of losses suffered by the retail houses on SCI activity are shown in Table II. These firms suffered losses of $42.9 and $83.1 million during the last quarter of 1969 and the first quarter of 1970. In the months of April and May, they lost $23.4 and $9.9 million, respectively. On an annual basis, that is assuming a continuation of the losses for a full year, the fourth quarter losses become $171.5 million. By comparison, the first quarter losses annualized come to $332.5 million. The April and May deficits annualized total $281.2 and $119.1 million, respectively.

The retail firms in our sample received $8.4 million in service charges during April and $16.2 million in May. Had it not been for this service charge, the losses in April would

have risen from $23.4 to $31.9 million, and in May from $9.9 to $26.1 million. Thus, even in the month of May, with volume up, the *annual* deficit would have been $313 million without the service charge—a deficit much above the $171 million per annum in the fourth quarter of 1969.

The retail firms received over 90 percent of the revenues generated by the service charge. Nonetheless, the amount has been insufficient to eliminate, on average, the losses involved in the retail commission business. At the level of volume in April and May, the service charge provided about two-thirds of the anticipated revenue. But even if all of it had been realized, the firms would have had a hard time breaking even.

Retail Firms—Overall Profits

Overall profits for retail firms show an even bleaker trend than SCI activity alone. During the last quarter of 1969, this group earned an overall profit before taxes of $33.2 million. Activities other than commission business provided profits of $76.1 million. However, profits on these other operations have declined to $70 million in the first quarter of 1970 and a deficit of $4 million during May. The service charge is of course justified and needed on the basis of securities commission operations alone. Nonetheless, it should be noted that retail firms are unable to subsidize losses on commission business with earnings from other lines of activity.

Middle Firms—SCI Business and Overall Profits.

There were 13 firms in the sample which averaged between 400-999 shares per order in 1969. Although their SCI business remained profitable during the periods under study, the trend would have been sharply downward if not for the service charge. Commission profits declined from $6.7 million in the last quarter of 1969 to $4.6 million in the first quarter of 1970 and $1.4 million in April. In May, the total came to $2.6 million, of which half was accounted for by the service charge. Although these firms received less

than 8 percent of the revenues generated by the interim fee, the service charge was crucial in reversing the downward trend in the profitability of their SCI business.

The overall business of these diversified firms shows a much poorer picture. At annual rates, these firms suffered deficits of $32.3 million in April and $48.7 million in May.

Institutional Firms—SCI Business and Overall Profits.

Seven firms fell into the institutional category. Profits on their commission business have declined since the fourth quarter of 1969. But thin trend has been vastly overshadowed by deficits in other lines of activity. Overall, these firms sustained annual rates of losses of $32.8 million in May, compared with $80.1 million in April.

In view of the fact that the service charge is only a slight proportion of the total revenue of these firms, it does not seem appropriate to analyze their financial situation in this connection.

* * *

On the basis of the above analysis, it is clear that the service charge has been an essential element in preventing an even more serious financial picture developing among the retail firms. Although the service charge has been insufficient to restore profitability, it has served to reduce the losses suffered by these firms on their SCI business from an annual rate of $330 million in the first quarter of this year to $119 million in May. The statistics indicate that the actual cost of the service charge to the public has not been $15 but has averaged less than $10 because of the 50% maximum ceiling imposed. The above data clearly support the need for continuation of the service charge at this time.

TABLE I

NUMBER AND PERCENTAGE OF FIRMS WITH PROFITS AND LOSSES ON SCI

	Quarter Ending December 31, 1969	*March 31, 1970*	*April 30, 1970*	*May 31, 1970*
Retail Firms				
Number with Profits	17	10	11	23
	31.5%	18.5%	20.4%	42.6%
Number	37	44	43	28
With Losses	68.5%	81.5%	79.6%	57.4%
Middle Firms				
Number	12	10	10	12
with Profits	92.3%	76.9%	76.9%	92.3%
Number	1	3	3	1
with Losses	6.7%	23.1%	23.1%	6.7%
Institutional Firms				
Number	7	5	4	5
with Profits	100.0%	71.4%	57.1%	71.4%
Number	0	2	3	2
with Losses	0.0%	28.6%	42.9%	28.6%
Totals				
Number	36	25	25	40
with Profits	48.6%	35.5%	35.5%	54.1%
Number	38	49	49	34
with Losses	51.4%	64.5%	64.5%	45.9%

TABLE II

DOLLAR AMOUNT OF PROFITS AND LOSSES ON SCI BUSINESS

(Millions of Dollars)

	Quarter Ending December 31, 1969	*Quarter Ending March 31, 1970*	*Month Ending April 30, 1970*	*Month Ending May 31, 1970*
Retail Firms				
Actual	($42.9)	($83.1)	($23.4)	($9.9)
Annualized	($171.5)	($332.5)	($281.2)	($119.1)
Middle Firms				
Actual	$6.7	$4.6	$1.4	$2.6
Annualized	$26.8	$18.2	$17.0	$31.7
Institutional Firms				
Actual	$16.6	$11.5	$3.2	$4.1
Annualized	$66.4	$46.1	$39.0	$49.5
Totals				
Actual	($19.6)	($67.0)	($18.8)	($3.2)
Annualized	($78.4)	($268.0)	($225.6)	($38.4)

TABLE III

NUMBER AND PERCENTAGE OF FIRMS WITH PROFITS AND LOSSES ON OVERALL BUSINESS

	Quarter Ending December 31, 1969	*Quarter Ending March 31, 1970*	*Month Ending April 30, 1970*	*Month Ending May 31, 1970*
Retail Firms				
Number with Profits	30 55.6%	16 29.6%	12 22.2%	16 29.6%
Number with Losses	24 44.4%	38 70.4%	42 77.8%	38 70.4%
Middle Firms				
Number with Profits	12 92.3%	11 84.6%	7 53.8%	7 53.8%
Number with Losses	1 6.7%	2 15.4%	6 46.2%	6 46.2%
Institutional Firms				
Number with Profits	6 85.7%	6 75.7%	4 57.1%	4 57.1%
Number with Losses	1 14.3%	1 14.3%	3 42.9%	3 42.9%
Totals				
Number with Profits	48 64.9%	33 44.6%	23 31.1%	27 36.5%
Number with Losses	26 35.1%	41 55.4%	51 68.9%	47 63.5%

TABLE IV

DOLLAR AMOUNT OF PROFITS AND LOSSES ON OVERALL BUSINESS
(millions of dollars)

	Quarter Ending Dec. 31, 1969	*Quarter Ending March 31, 1970*	*Month Ending April 30, 1970*	*Month Ending May 31, 1970*
Retail Firms				
Actual	($33.2)	($13.6)	($19.3)	($13.8)
Annualized	($132.8)	($54.2)	($232.1)	($165.7)
Middle Firms				
Actual	$25.8	$11.1	($2.7)	($4.1)
Annualized	$10.3	$44.5	($32.3)	($48.7)
Institutional Firms				
Actual	$29.5	$22.6	($6.7)	($2.7)
Annualized	$118.1	$90.5	($80.1)	($32.8)
Totals				
Actual	$88.5	$20.1	($28.7)	($20.6)
Annualized	$354.0	$80.4	($344.4)	($247.2)

For RELEASE Thursday, October 22, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 9007

The Securities and Exchange Commission today announced that it had reviewed the proposed New York Stock Exchange minimum rate schedule, which it received June 30, 1970, as well as the evidence presented in the public hearings on that subject. As a result of its review, the Commission has concluded that the data submitted in support of the NYSE's proposal does not provide a complete answer to the problem of stock exchange commission rate structure and level. It believes, however, that it would not be in the public interest to leave this subject indefinitely in abeyance and accordingly would not object if the proposed schedules are adopted with the modifications related below, and also upon the understanding that specified steps be taken to provide a better basis for the determination of commission rates.

Generally stated, the Commission has concluded that (i) the proposed increases in rates for round-lot orders of 100 through 400 shares are unreasonable and should be reduced to stated percentages and (ii) that the proposed rate schedule is unreasonable to the extent that it fixes charges for that portion of an order in excess of $100,000. The Commission determined that it would not object to the proposed schedule if it is modified to take into account the Commission's objections noted above. The Commission also indicated that its action is in part predicated upon the need for member firms to adequately service the small investor and, accordingly, conditioned on the understanding that no member firm which traditionally has accepted small customer accounts will impose or continue

any limitation on the size of such customer's order or account and that in connection with such business the firm will not charge fees in excess of the proposed rates. The Commission also stated that it expects that the Exchange will take all steps necessary to assure that these revenues will be prudently employed by all of its member organizations to improve their operations and financial position.

To provide a better basis for the determination of rates, the Commission has requested that the Exchange present for the Commission's consideration on or before but no later than June 30, 1971

(1) a new rate structure based on a percentage scale of the money involved in an order;

(2) a proposed revision of the intra-member charges for floor brokerage and clearance; and

(3) a proposal for reasonable non-member access.

Finally, the Exchange was requested to develop and submit a plan by May 31, 1971 for a uniform system of accounts and uniform methods of cost allocation. The Commission's conclusions are set forth in a letter to the Exchange President, Robert W. Haack, the full text of which follows:

EXHIBIT 35

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

October 22, 1970

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

The Commission has reviewed the proposed New York Stock Exchange minimum commission rate schedule which it received June 30, 1970, and the evidence presented in the public hearings on that subject. As a result of its review, the Commission has concluded that the following segments of the schedule are not reasonable:

(1) *Commissions to be charged for orders of 100-400 shares.*

The Commission believes that the schedule proposed for orders of 100-400 shares is unreasonable in terms of the percentage increase it represents over the present minimum commission rate schedule and the rate of commissions charged more recently with the imposition of the interim service charge in addition to the present schedule. Investors purchasing this number of shares would be required, under the proposal, to bear an inordinate amount of total commission increase sought by the Exchange. The Commission has determined that increases in these particular minimum commission rates would not be unreasonable if they were reduced in the 100 through 400 share order categories at the $40 per share price level, as shown in the schedule below,

with proportionate reductions for other price levels in these share order categories.

Number of Shares	Proposed Increase of	Reduced To
100	50%	37%
200	45%	34%
300	35%	26%
400	25%	20%

(2) *Commissions to be charged for portion of orders exceeding $100,000 or more.*

The Commission is of the opinion that fixed charges for portions of orders in excess of $100,000 are neither necessary nor appropriate.

The Commission believes that the remainder of the proposed schedule is not unreasonable and that the schedule, if adopted as modified as suggested in (1) and (2) above, will afford member firms an income consistent with their interests and the interests of investors and the public at large. The Commission's action is in part predicated upon the need for member firms to adequately service the small investor and, accordingly, is conditioned on the understanding that no member firm which traditionally has accepted small customer accounts will impose or continue any limitation on the size of such customer's order or account and that in connection with such business the firm will not charge fees in excess of the proposed rates. The Commission also expects that the Exchange will take all steps necessary to assure that these revenues will be prudently employed by all of its member organizations to improve their operations and financial positions.

Consistent with the representations made by the Exchange of the need for continuous review of commission charges, the Commission will re-examine the level and structure of rates for the period following July 31, 1971. For

this purpose, the Commission requests the Exchange as soon as possible but no later than June 30, 1971, to present for Commission consideration a new rate schedule of scaled percentage charges based upon the amount involved in an order. Such a rate schedule should be fair, readily understandable and not present undue problems of administration.

The Exchange also is requested on or before that date to present a plan for reasonable economic access to the New York Stock Exchange for non-member broker-dealers. Further, the Exchange is requested on or before June 30, 1971, to submit appropriate revisions relating to intra-member rates.

Finally, the Commission considers it to be necessary to the continuance of a system of fixed rates for exchange transactions that a uniform system of accounts as well as uniform and adequate methods of cost allocations be implemented. Accordingly, the Exchange should present at the earliest practicable date and not later than May 31, 1971 a plan for such uniform accounting system. At the same time, the Commission will be considering such a plan for all registered broker-dealers.

If the Commission or its staff can be of assistance to the Exchange in regard to our suggested modifications of its proposed schedule, please let us know.

Sincerely,

Hamer H. Budge
Chairman

LETTER DATED FEBRUARY 3, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

As your February 3, 1971 letter indicates, in early January the Commission advised representatives of the Exchange that delay in implementation of the elimination of minimum commission rates on large orders for the purpose of enabling the Exchange to undertake a study of whether such action should be taken was unacceptable.

You have described in some detail concurrent and subsequent activities of the Exchange's Committee on Membership Qualifications concerning institutional membership. We see no reason why the Costs and Revenues Committee's or the Board's resolution of the competitive rate issue "must logically await the development of definitive recommendations" respecting institutional membership. As you know, we did not suggest in our October 22, 1970 letter, nor do we now suggest that Exchange action on the implementation of competitive rates for institutional size orders should await resolution of various issues referred to in the Commission's October 22 letter or of questions concerning Exchange Rule 318.

Accordingly, particularly in view of the time that has elapsed since the Commission's letter of October 22, the Commission believes the Exchange should take immediate action to implement, by April 1, 1971, the Commission's finding that fixed minimum commissions on institutional size orders are neither necessary nor appropriate. In light of bustantial charges in trading patterns on the New York Stock Exchange and to gain further experience with competitive rates, the Commission will not object to the

Exchange's commencing competitive rates on portions of orders above a level not higher than $500,000 rather than at the $100,000 figure mentioned in our October 22 letter.

Sincerely,

Richard B. Smith
Commissioner

SRappaport/bmj

For RELEASE Thursday, March 11, 1971

Securities and Exchange Commission
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 9105

The Securities and Exchange Commission today announced that it had yesterday sent a letter to the New York Stock Exchange reaffirming the conclusion in its March 8, 1971 letter that the continuation of minimum commission rates on portions of orders above $500,000 beyond April 2, 1971 would be unreasonable and would be contrary to the Exchange Act. The Commission requested the Exchange to so advise its members and stated that the conclusions reached in the Commission's March 8 letter are not altered by the timing of the Exchange's procedural steps to amend its constitution or their outcome. The Commission's March 8 letter, the New York Stock Exchange's response of March 9 and the Commission's reply of March 10 follow:

March 8, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

As you will recall, on November 9, 1970 you wrote to the Commission stating the Exchange's assumption that the Exchange and its members would have a reasonable time to thoroughly study the conclusion in the Commission's October 22, 1970 letter that minimum commission rates on large, institutional size orders are neither necessary nor appropriate. On February 10, 1971 the Commission wrote to you that we would not object if competitive rates were to

apply to the portion of orders which exceed a cut-off point of not more than $500,000 and stated that the Exchange should take immediate action to implement such competitive rates by April 1, 1971.

We understand that the Exchange and its members have very recently been addressing themselves to a number of questions relating to competitive rates which are not yet resolved. Of course, the matter of competitive rates and related questions have been before the Exchange and its membership since October 22, 1970. The Commission appreciates that, as in other situations such as when the surcharge was adopted, the Exchange necessarily will be able to take appropriate interpretive action after as well as before rule changes are adopted.

As the Commission has previously advised the Exchange, the time to implement such competitive commission rates would not extend beyond April 1. However, if operational problems would result from the change occurring during the middle of a business week, the Commission will not object to the Exchange retaining minimum commission rates on such orders through April 2, 1971. Accordingly, your members should be advised promptly that the continuation of minimum commission rates on those portions of such orders beyond that time would be unreasonable and would be contrary to the Exchange Act.

Sincerely,

FOR THE COMMISSION
Hugh F. Owens
Commissioner

March 9, 1971

The Honorable Hugh F. Owens
Office of The Commissioner
Securities and Exchange Commission
500 N. Capitol Street
Washington, D.C. 20549

Dear Commissioner Owens:

As per our discussion with the Commission yesterday morning, and in response to your letter of March 8, we appreciate the opportunity to outline to the Commission what the Exchange is doing to implement competitive rates on orders exceeding $500,000.

Before such a change can be made it is necessary to amend Article XV of the Exchange Constitution dealing with "Commissions and Service Charges." Article XX of the Exchange Constitution contains the procedure which the Board of Governors must follow in proposing amendments to the Constitution. Amendments to the Constitution can only be approved or disapproved by the Exchange membership.

Article XX of the Constitution provides that every proposed amendment to the Constitution must be presented in writing at a regular meeting of the Board or at a Special Meeting called expressly for receiving it. Upon presentation, the proposed amendment must be laid upon the table for at least two weeks. After the minimum two week posting period, the Board of Governors may approve the amendment and submit it to the membership for a vote.

Article XX also provides that the time for balloting shall expire at the end of two weeks following approval and submission of the proposed amendment by the Board of Governors, unless at the end of the two week period less than a majority of the then members have participated in the balloting.

Accordingly, a minimum period of four weeks is required, assuming membership approval, to amend the Exchange Constitution. In addition, Exchange Rule 28 provides that in the case of amendments to Article XV of the Constitution "the text of such amendment shall be posted on the bulletin board, distributed to the membership and publicly announced at least 30 days before action thereon is taken by the Board of Governors." In other words, Rule 26 has the effect of extending the minimum posting period for amendment to the commission Article of the Constitution to 30 days rather than the two weeks required for amendments to other Articles of the Constitution.

The timetable which we have been following, as explained to the Commission at the meeting yesterday morning, calls for a series of meetings to be held with various groups dealing with aspects of the problems which have been raised in connection with the new structure of commission rates which will come into being with the establishment of competitive commission rates. A meeting was held yesterday with representatives from the operational side of the business, and meetings were held today with counsel on the legal questions which have been raised.

A meeting is to be held on intra-member rates in view of the Commission's letter of March 2, which we received last Wednesday, notifying the Exchange that it expected that fixed intra-member rates above the $500,000 level would also cease to apply.

A meeting of the full Costs and Revenues Committee is scheduled for this Thursday, March 11, to review the various recommendations which will hopefully be developed as a result of the consideration of the various problems which are being explored.

We recognize, as the Commission states in its letter of March 8, that the Exchange will be able to take ap-

propriate interpretative action after as well as before rule changes are adopted. However, here we are dealing with a new structure of commission charges which, in effect, overturn commission rates and practices which have existed in the securities industry for many, many years. In our review we have been attempting to visualize the practices which might arise under a scheme of competitive rates. It may be that some of these practices will be inimical to the public interest and therefore must be addressed by the Exchange prior to the implementation of a new commission structure rather than to react to practices after abuses occur.

We are not, as has been repeatedly emphasized to the Commission and its staff, proposing that the implementation of competitive rates be delayed for the sake of delay. We do feel, however, that as thorough an exploration of the problem areas as is possible should be done in the shortest possible time.

As we stated at the meeting with the Commission yesterday, we are proposing that a proposed amendment to the Exchange Constitution be laid upon the table at the policy meeting of the Board of Governors on March 18. As you know, out-of-town memebers and the three public members of the Board of Governors do not ordinarily attend the weekly meetings of the Board and major matters are reserved for the Board at the policy meeting held on the third Thursday of the month.

When the proposed amendment is laid upon the table at the policy Board meeting on March 18, we also plan to propose that the board repeal Exchange Rule 26 and thereby shorten the posting period from 30 days to two weeks. After the expiration of the minimum two week posting period, we will move that the Board approve the proposed amendment and submit it to the membership for balloting. As explained previously, the minimum two week balloting period would expire on Thursday, April 15, if this schedule is adhered to.

We have asked the Exchange's counsel, Milbank, Tweed, Hadley and McCloy, for its opinion on the legal impact of the last sentence of your letter of March 8, 1971, before any notice is sent to the Exchange membership.

We hope that the Commission appreciates that we are working diligently on the questions raised by the implementation of a scheme of competitive rates and that the Board of Governors of the Exchange must, absent appropriate commission action under Section 19(b) of the Securities Exchange Act of 1934, adhere to the requirements of the Exchange Constitution in effecting changes in commission rates.

This means that it will not be possible for the Board of Governors, acting under the requirements of the Exchange Constitution, to implement competitive rates on orders exceeding $500,000 prior to April 1 or April 2, but that such rates can be made effective as early as April 16. However, since April 16 is a Friday, for operational reasons it would be advisable to make the change effective on the following Monday, April 19.

In view of the magnitude of the proposed change, the prospect of the continuation of the existing system of fixed minimum commission rates for ten additional trading days beyond April 2 does not seem unreasonable. Whether the Commission's position is legally correct or not, it does not seem that much is accomplished by exposing the member organizations and the exchanges to potential lawsuits, which may be litigated for years, to accelerate the implementation of competitive rates on larger transactions by a few days.

We hope that the Commission will agree and advise us that it has no objection to the Exchange's retaining the existing minimum commission rates through April 16. Let me assure you that Chairman Lasker, Vice-Chairman DeNunzio and I have every intention of following through

with this schedule on March 18, if the Commission approves.

Very truly yours,

Robert W. Haack

March 10, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

This is in reply to your letter of March 9, 1971 in which you respond to our letter of March 8 with respect to commission rate structure by describing the action which the Exchange has taken and proposes to take pursuant to various provisions of your constitution to bring about a modification of Article XV of the constitution to introduce competitive commission rates on that portion of orders which exceeds $500,000. It expresses the view that all of these procedural steps cannot be concluded prior to April 16 or perhaps April 19.

If this were an initial proposition which was first called to your attention on March 8, we would endeavor to accommodate your concern. However, the Commission's determination, following extensive hearings, was brought to your attention on October 22, 1970 and on February 10, 1971 you were advised that action should be taken by April 1. Procedural steps required by your constitution could have been initiated earlier, but we are not attempting to determine the timing of the procedural steps you take pursuant to your constitution. We do, however, adhere to the statement in our letter of March 8 that the continuation of minimum commission rates on portions of orders above

$500,000 beyond April 2, 1971 would be unreasonable and would be contrary to the Exchange Act and we believe that you owe it to your members to so advise them. We assume that in view of this, the procedural steps under your constitution will be taken as rapidly as possible, but the conclusions reached in our letter of March 8 are not altered by the timing of those steps or their outcome.

Sincerely,

FOR THE COMMISSION
Hugh F. Owens
Commissioner

Statement of the Securities and Exchange Commission

on the

FUTURE STRUCTURE OF THE SECURITIES MARKETS

February 2, 1972

MEMBERS OF THE COMMISSION

William J. Casey, of New York, *Chairman* . . . . June 5, 1974
Hugh F. Owens, of Oklahoma . . . . . June 5, 1975
James J. Needham, of New York . . . . . June 5, 1973
A. Sydney Herlong, Jr., of Florida . . . . . June 5, 1976
Philip A. Loomis, Jr., of California . . . . . June 5, 1972

A. Jones Yorke, *Executive Director*
Ronald F. Hunt, *Secretary of the Commission*

STATEMENT BY WILLIAM J. CASEY, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION, UPON RELEASE OF THE COMMISSION'S POLICY STATEMENT ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS—FEBRUARY 2, 1972

The Commission is today issuing a policy statement which undertakes to speak not only to the subjects specified in the hearings held at the end of last year, but also to other still unresolved questions thrashed out in the Commission's hearings going back to 1968. Indeed, our statement on the future structure of the securities markets is the culmination of hearings and studies extending over the last decade. Yet, it is a beginning, for it points the way for the future, a future in which the securities industry and markets will perform an even more vital function in the economy of our country. Beyond that, we visualize the role that this industry has performed in our economy broadening to all the free economies of the world. In reaching our conclusions we tried to preserve that which is good to provide a foundation for improvement in the future.

The members of the Commission have a remarkable degree of unanimity in our view of what the securities markets should look like in the future and on what the Commission should do to guide and assist in evolving in this direction. This statement expresses the unanimous view of all the members of the Commission except that Commissioner Owens takes a different view at one point on the best method of achieving the goals which we all share. All of us fully agree on all the objectives and almost all the means of working toward markets which are public markets, staffed by professionals, retaining the confidence of individual investors that their interests are not neglected, and providing necessary depth and liquidity, by unification and by reliance on competition within the market structure, not outside it.

The policies which the Commission is adopting in this report focus on three paramount objectives. First, we want to make the relationships in the securities markets and their operation as simple, as direct, and as open as we can. They have become too complicated with too many transactions structured, contrived, and carried out in a particular place or in an unnatural way or without public disclosure—sometimes all three. The steps spelled out in this report are designed to put competition to work for the investor, to move away from reciprocal and rebative practices, to bring transactions into the open and to focus attention where it should be—on where and how to get the best price for a buyer or seller of securities. We believe that investor confidence will be strengthened as professional attention is reconcentrated on finding the best market, providing information and judgment for the investor, and getting him the best net result, unclouded by considerations relating to the rebating, the redirection and the recapturing of commissions.

The second is to adapt the securities markets to growing institutionalization, with its increased tempo and magnitude of transactions, while maintaining the confidence and the participation of the individual investor. This will require absorbing more and larger blocks from institutions without creating spreads and price gyrations which frighten the small investor and while maintaining the depth and liquidity which has attracted investors from all over the world to our markets. That is the biggest challenge we face. We believe it can be met by bringing all offers and bids together into a single nationwide market system, by making quotations and transactions known in all parts of the country, by bringing all market-makers to a central system in which they compete under rules assuring responsibility, by giving the public an opportunity to participate in, or by protecting smaller holdings from, the discounts and premiums at which large blocks trade. This is a very difficult, technical and sensitive problem. The

Commission and the staff will work closely with professionals in the securities industry to further evaluate and implement these key aspects of the central market system.

Our third emphasis is on making the professional service available to investors as efficient and economic as possible without diluting standards of service and responsibility. We all believe strongly that the market system of the future should be operated by professional brokers and market-makers dedicated primarily to serving the public in these capacities. We believe it is harmful to public confidence and to the kind of professional responsibility which should characterize our securities markets for brokerage firms to have the privilege of exchange membership without the obligation, the responsibility and primary purpose of serving a sector of the public other than their own affiliates. To this end, the Commission will use its authority as promptly as possible to eliminate the rebative and reciprocal practices specified in our report and to eliminate exchange memberships which do not clearly have a primary purpose of serving public customers. Commissioner Owens believes that these objectives require the total prohibition of all transactions by institutionally affiliated brokerage firms for their institutional affiliates. The other Commission members are not prepared to go that far at this time. All of us believe that the Congress should again review this and other conflicts of interest to weigh any deficiencies in the present method of controlling them by a combination of disclosure and fiduciary obligation against the impact of complete separation of function on the strnegth of the industry and its service to the public.

The Commission will act as promptly as possible to extend competition in commissions and market-making while maintaining the obligation of determining suitability in the sale of securities, encouraging the performance and broad dissemination of investment research and fostering

efficiency and financial responsibility in brokerage firms. Specific steps to be taken are spelled out in our policy statement. (See page 24)

STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS

February 2, 1972

The Commission is issuing this general statement of policy at this time so that the Congress, the investing public and the securities industry fully understand the Commission's views on the present status of the securities markets and the direction in which the public interest requires that they evolve in the future.

The Commission has completed a series of hearings and special studies extending over a period of three and a half years. The latest set of hearings, which began on October 12, 1971, dealt primarily with questions related to the structure, organization and regulation of the securities markets. Earlier hearings dealt primarily with questions relating to commission rates and give-up practices. The Institutional Investor Study, submitted to Congress on March 10, 1971, accumulated extensive data on the burgeoning of financial intermediaries such as banks, mutual funds, pension funds and insurance companies, often referred to simply as institutions, and their growing impact on the securities markets. Finally, the "Study on Unsafe and Unsound Practices of Brokers and Dealers," mandated by the SIPC legislation and submitted to Congress on December 28, 1971, dealt with questions relating to the operational efficiency and financial responsibility of firms making up the broker-dealer community.

This policy statement is based on the data and testimony accumulated in this entire process of hearings and studies. It draws on the Commission's analysis of that data, as well as on the experience gained through its years of administering the securities laws.

The continued strength and vitality of the American

securities markets are essential to the economic welfare of all Americans. We have the best capital market in the world. It attracts investment not only from millions upon millions of Americans and the financial institutions responsible for their savings but from investors in all corners of the world. This attraction comes from the depth and liquidity of our market, from the quality of the information and research available about our companies and from the standards of service and responsibility to investors which prevail in our investment community.

Yet disturbing problems have developed. Institutions entrusted with rapidly increasing amounts of the nation's savings have sharply increased the amount of trading they do in the equity markets. Much of this trading is directed to markets where it is possible to rebate or redirect commissions and where the public is not aware of the prices or the volume involved. Our securities markets depend on public confidence and public participation. In our study on unsafe and unsound practices we have reported on steps taken to assure the public of the financial responsibility of those who serve investors and steps recommended to fully utilize modern technology in effectuating securities transactions.

In this policy statement we address what can be done now to assure the public that market structure is responsive to its needs. The public is entitled to disclosure of trading volume and prices in all markets. It is entitled to have competition focused on providing the best combination of price, service and transaction cost. It is entitled to regulation designed to assure fair, open and direct dealing and, to the extent feasible, to maintain price stability and market depth.

The policies set forth in this statement are designed to deal with the following specific problems which have developed in our markets:

1. With the growing institutionalization of the

market, large blocks have come to account for close to 20 percent of the volume. The auction market and the specialist system have not been able to absorb this pressure without the assistance of other dealers.

2. Widespread attempts to avoid the fixed commission rate or to use commission payments as compensation for other services unrelated to the brokerage function have resulted in a dispersion of trading to the point where an investor's ability to know whether he has obtained the best execution of his order is threatened and the potential depth and liquidity of the marketplace have been impaired.

3. Reciprocal practices have proliferated to the point where they, along with restrictions on brokers' access to markets, have clouded disclosure and responsibility in the execution of orders for listed securities.

4. An increasing amount of trading in listed securities is not disclosed to the public.

The policies set forth herein are also designed to preserve and strengthen these capabilities which our markets have developed:

1. The remarkable ability of block positioners and other market-makers, including some specialists, to handle the large offerings and bids which come from the institution.

2. The network of securities firms capable of providing needed services to the public and mobilizing capital from all parts of America.

3. The high standards of fiduciary responsibility with which most securities firms serve public customers.

4. The professional investment research capabilities which have been developed to guide investor's capital on an informed basis and in the light of potential risk and reward.

In brief, these policies are designed to maintain depth and liquidity by concentrating trading in a central market system in which competing market-makers will generate the best prices, in which comprehensive disclosure will show how and where to obtain the best executions, to which all qualified broker-dealers will have access, and in which every investor can have the assurance that the professionals acting as his agents will put his interests before theirs. At the same time, we seek to move towards a structure of rules as to commissions and related matters which will eliminate gimmickry and minimize distortion and indirection in the trading of equity securities.

As things now stand, we believe that fundamental changes in trading practices, particularly the institutionalization of trading, and the nature of the prevailing commission rate structure have combined to produce fragmentation among the components of the marketplace for listed securities. Similarly, the trading of increasingly large blocks of securities has cast doubt on the ability of the marketplace to continue to provide the liquidity and price continuity which have made our markets function so well.

In evaluating alternative policies and introducing change the most critical task is the designation of objectives. In this case, our overall objective is to encourage the development of capital markets with the ability to mobilize capital effectively and in so doing to allocate resources efficiently, establish realistic and fair valuation of investments, provide necessary liquidity for securities and produce satisfactory investment services and protection for those who commit their savings to the securities markets, in whatever form. We believe these objectives can be attained by reliance on economic incentives and market mechanisms, consistent with our national policy of favoring free and open competition, except in those specific instances where the regulator's duty to protect the public dictates a limited departure from free market principles.

A CENTRAL MARKET SYSTEM

In order to maximize the depth and liquidity of our markets, so that securities can be bought and sold at reasonably continuous and stable prices, and to ensure that each investor will receive the best possible execution of his order, regardless of where it originates, it is generally agreed that action must be taken to create a single central market system for listed securities. The Commission in its letter transmitting the Institutional Investor Study to Congress called for a central market system with open access by all qualified brokers and market-makers. This represented something of a shift in the historic position of the Commission, which over many years, extending from before World War II to at least the Special Study Report of 1963, tended to favor competing but separate markets. This shift resulted from technological developments which made it possible to tie markets together so that one could foster competition within a central market rather than among separate competing markets and also from the need to strengthen the existing market structure, including increased market-making capacity within the structure, in order to cope with the pressures created by the growth of institutions and the volume of their trading. This central market system must be one which will attract and reflect all bids, offers and market-making activity in order to maintain maximum liquidity and depth.

The term "central market system" refers to a system of communications by which the various elements of the marketplace, be they exchanges or over-the-counter markets, are tied together. It also includes a set of rules governing the relationships which will prevail among market participants. To mandate the formation of a central market system is not to choose between an auction market and a dealer market. Both have an essential function and both must be put to work together and not separately in the new system.

Doing this should achieve the twin objectives of centralizing all buying and selling interest and maximizing market-making capacity. While the Commission believes it is important that a tandem central market system also evolve for unlisted securities, and recognizes that significant strides are being made in this direction through NASDAQ, this report will concern itself only with such a system for listed securities. We nonetheless note our satisfaction with the manner in which the NASDAQ communications system has been operating and intend to continue to monitor its operations and development in order to determine whether any modifications may be necessary as the evolution of a central market system progresses.

The national market in listed securities is presently divided between stock exchanges and the third market, with a relatively insignificant amount of trading occurring directly between investors without any intermediation. A central market system would internalize within that system, and make visible to the investing public, the competition which now takes place among the separate exchange markets and between all of them and the third market. The competition which now exists is not always focused on the best brokerage services obtainable but is often based as well on the ability to divert part of the commission involved in a transaction to the interests of those who initiate it and which are not necessarily the same as those of the beneficial parties involved. The trades resulting from this competition and the arrangements it spawns are not always publicly disclosed.

The central market system we look towards should be designed not only to strengthen competition but to make its operation direct and comprehensible and its results fully public. It would entail, among other things, the following elements:

1. Implementation of a nationwide disclosure or

market information system to make universally available price and volume in all markets and quotations from all market makers.

2. Elimination of artificial impediments, created by exchange rules or otherwise, to dealing in the best available market.

3. Establishment of terms and conditions upon which any qualified broker-dealer can attain access to all exchanges. (Progress in this direction has already been achieved by a provision for a 40 percent discount from prescribed commision rates for brokers who are not members of the NYSE. Experimentation with this access provision may lead to further proposals for greater access.)

4. Integration of third market firms into the central market system by including them in the disclosure system (even though initially they would report principal trades on a net basis while exchange trades do not give effect to commissions) and making them subject to appropriate market responsibilities and other regulatory requirements commensurate with the benefits they may realize.

Before discussing these elements in more detail, two other matters related to development of the system are noteworthy. As the system evolves towards general access to exchange facilities it may, depending upon the nature of such access, become appropriate to provide for compensation to seat holders who invested in their seats with the reasonable expectation that such access would remain strictly limited. This could be done by means of a transaction surcharge or some form of tax relief, as the Department of Justice has suggested in its statement recently filed with the Commission. Furthermore, as the central market system evolves, changes may be desirable in the nature and function of the self-regulatory organizations. We anticipate that during the developmental stages the self-regulatory organizations will make

changes appropriate to the new system. It is not necessary, however, to attempt to design at this time a self-regulatory structure for a system, the outlines of which are still not sharply defined.

A Comprehensive Disclosure System

As indicated above, an essential step toward formation of a central market system is to make information on prices, volume and quotes for all securities in all markets available to all investors, so that buyers and sellers of securities, wherever located, can make informed investment decisions and not pay more than the lowest price at which someone is willing to sell nor sell for less than the highest price a buyer is prepared to offer. Such a communications system would thus serve to link the now scattered markets for listed securities.

Actions towards establishing such a system has already been initiated by a working committee formed by the industry for this purpose. It is expected to progress rapidly, assuming that the heterogeneous components of the securities industry continue to demonstrate a homogeneous resolve. The committee has met to discuss alternative approaches and recently gave the Commission a progress report on its initial deliberations. The Commission will monitor the progress of the committee (and its expanded successor discussed below) actively to ensure that the common goal is attained as swiftly as possible.

To the extent the communications system will contain substantially real time information on quotations and completed transactions, existing rules must be broadened and reshaped to protect the public against any manipulative abuses, such as certain kinds of short selling, to which such systems may be subject. Technological means must be found to bring together promptly transactional information from all markets and, if feasible, to present it on a single tape. Because of legibility problems, it may be desirable to develop instead a tape for very actively

traded securities and to supplement it for less actively traded securities with a separate tape or a recall system which would provide data on last sale, cumulative volume and current quotes. Alternatively, a tape might be developed which would contain *all* desired information but which could be viewed on a selective, though real time, basis.

In addition to developing a composite transactional tape, steps must be taken to implement a composite quotation system. The technology and hardware for such a system are said to be available and any remaining regulatory problems should be promptly worked out so that the system can attain its objective of providing quotations which are truly comparable, notwithstanding the different assumptions on which they may be based.

The Commission plans to work in conjunction with the industrys' committee to take all appropriate steps to achieve the foregoing as expeditiously as practicable.

As a concrete preliminary step the Commission will promptly promulgate rules under Section 17(a) of the Exchange Act to require that by the end of each day (or more frequently if feasible) price and volume information on each listed security be collected by each stock exchange and, in the case of third market trading, be reported by broker-dealers to and be collected by the NASD, under appropriate procedures and safeguards. Such rules would provide for release of the data by the end of each day to the public news media including newsppaers and, when feasible, to the composite or combined ticker or recall system and automated selective display system referred to previously. This will make it possible for investors to know aggregate trading volume and price ranges in a particular listed security in all markets in which it is traded. It is hoped that the media will cooperate with the Commission and the self-regulatory organizations to modify present reporting methods to include this additional information.

In any event, this information will be made publicly available as soon as possible, and the Commission looks forward to substantial progress toward the formation of a real time comprehensive market disclosure system before the end of the year.

Rules for Competing Market-Makers

A central market system, primarily through its communications network, can maximize the opportunity for public orders to match each other and be executed in classic auction market fashion. In addition, such a system can greatly increase the depth and liquidity of the marketplace by maximizing market making capacity; that is, the ability and willingness of dealers, including specialists, market-makers and block positioning firms, to buy and sell securities for their own accounts on occasions when the other side of a public order is not readily available. This can be done by encouraging all such dealers to compete actively within the system, without any artificial restraints between component markets, to provide the necessary buying or selling power on such occasions.

It must be recognized that when market professionals are permitted to deal for their own accounts with the public, prophylactic rules are required to avoid overreaching and other abuses. Similarly, as a condition of allowing professionals the right to represent and deal with the public in the market system, these professionals should be prepared to assume certain responsibilities in respect to the liquidity and orderliness of the market.

The Commission believes that the liquidity needs of individual and institutional investors can best be provided by policies fostering the development of competition among dealers who are specialists, market-makers and block positioners. Such competition will mitigate the very difficult problem which now exists of developing and enforcing rules designed not only to prevent specialists from

abusing their privileged position, but also to motivate them to perform satisfactorily under widely differing circumstances and in the light of varying risks and pressures. Nevertheless, the Commission recognizes that certain rules must be applicable to the competing specialists, third market maker and block positioning firms that will be the heart of the central market system. Such rules will be necessary for three reasons. First, not all listed securities have the trading volume and investor interest necessary to provide effective competition among market-makers (a very large proportion of listed securities trade fewer than, say, 1,000 shares a day). Second, even with the presence of competing market-makers, minimum standards are needed to assure that competition will exist in fact, not just in appearance. Third, it has long been recognized that the regulatory and self-regulatory bodies must help assure that such market-makers do not take unfair advantage of public investors.

Such rules and responsibilities can best be specified in detail by another working group formed for this purpose. This group will deal with problems such as the following:

1. How can we assure that trading by dealers is stabilizing rather than destabilizing in nature? Can this be controlled by standards more meaningful than the "tick test", including, for example, a daily net balance test?

2. To what extent, if any, should there be modifications of the existing system under which specialists are both obligated and limited to making markets in a specified group of securities, while block positioners endeavor to provide a market for almost any security in which an institutional customer has a buying or selling interest, and third market makers perform in a manner somewhere in between? To the extent that this difference in functions is preserved, what rules are appropriate in connection with each such function?

3. What standards of financial soundness should be applied to market-makers in relation to the number and the size of the markets they maintain as well as to whether or not they carry customers' accounts?

4. Who should have access to information about limit orders and are any restrictions necessary or desirable on dealings between specialists or other market-makers and institutions? It is the Commission's present view that (*a*) competing market-makers should have access to the book (or books), although this might require that it be made public, and (*b*) the ability to deal directly with institutions contributes substantially to a market-maker's ability to find demand and supply (increasing his willingness to take positions and thus improving liquidity), and the presence of competing market-makers would reduce the likelihood of the abuses which gave rise to the existing restrictions on such dealings.

General

We have not attempted at this time to decide certain questions which, in our view, can appropriately be resolved only when the central market system has evolved further. These include such matters as whether trading in listed securities should be restricted to that market system, and whether institutions should be required to limit their transactions in listed securities so that market system rather than doing business directly with each other.

Block Trading

Much concern has been expressed about the market impact of the manner in which institutions acquire and dispose of large positions in listed stocks. The ever-increasing proportion of trading in listed securities accounted for by blocks has taxed the capacity and willingness of specialists, as well as other market makers,

to absorb large blocks. While the Institutional Investor Study found that on an overall basis and over extended periods of time—usually about a month—institutional trading did not lead to instability in the market, it appears that such instability does occur frequently in the short run. The impact of institutional trading in particular instances may thus be felt by the markets in general and public investors in particular through substantial fluctuations in the value of their holdings, whether as individuals or through pools of invested capital.

It is in the interest of all concerned, including investors of all sizes, corporate issuers and broker-dealers, that institutional trading not be permitted to deprive our capital markets of their basic liquidity and orderliness. A relatively small number of brokerage firms specializing in block transactions have to date performed a remarkable service in maintaining liquidity for large blocks and minimizing their impact on the public marketplace, but there can be no assurance that they will continue to do so. We have been told that lowering the level at which commission rates are subject to negotiation would deprive the block firms of some of the commission "cushion" they employ to reduce their risk of loss on blocks they temporarily take into inventory to facilitate block trades. Their ability to handle large blocks would thus be diminished, which would result in larger discounts and premiums in the movement of large blocks. Accordingly, ways must be found to ensure that these disruptions in the manner in which securities are priced in the market-place are minimized, at least to the extent they are a result of liquidity preferences and not in response to information generally available to public investors.

A wide range of approaches has been suggested. One type of proposal is directed at decreasing the volume of block trading by imposition of limitations on the ability of institutions to change positions, or of market makers and

block positioners to assist institutions to change positions, rapidly in circumstances where the market impact is likely to be severe. Another type of proposal would accept the possibility of greater price gyrations from institutions' block trading and would focus on finding ways to enable the public to participate in the block premiums or discounts. A third type of modification would recognize the fundamentally different nature of block transactions, as distinguished from normal retail auction transactions and, with the aim of avoiding retail market price fluctuations, would accord them separate treatment. For example, blocks might be crossed and reported on a tape but not interfaced with the retail auction process; that is, limit orders on the specialist's book would not participate at all.

The foregoing proposals all raise very difficult questions and involve competing theories as to the kinds of markets that are most efficient and fair.

We would be reluctant to see any restriction on the liquidity of large blocks. Yet the cost of such liquidity may be greater price fluctuations. If greater price flutuations, springing from the desire on the part of institutions to have instant liquidity, are to affect the value of individual holdings, directly or in pools, perhaps the public should have the opportunity to participate in resulting discounts and premiums. It also may be that requiring institutions to reflect the size of their holdings (through haircuts) in valuing their portfolios would result in a better balance between the propensity to accumulate large blocks and the expectation of instant liquidity. Better rules, procedures and incentives for positioning and redistributing large blocks may contribute to the resolution of these difficult problems.

An additional working group will be created to study and recommend rules needed to improve the handling of large blocks. Reports on the respective merits of the various approaches, and related proposals for implementation, will

then receive thorough consideration by the Commission, which will consider both the problems and the suggested changes in the context of the central market system that will be evolving.

QUALITY OF SERVICE TO THE INVESTOR

Section 2 of the Securities Exchange Act of 1934 states that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest". Just as surely the brokers and dealers who execute such transactions are so affected. They are entrusted with money and securities belonging to investors of all sizes, including those whose savings are invested indirectly through large pools of funds. It is therefore crucial that these brokers and dealers conduct their activities in a manner consistent with the high standards imposed upon them by the Act and the needs and expectations of the investing public.

An important step toward eliminating the many discredited practices which caused concern about the ability and willingness of some members of the broker-dealer community to live up to such standards was the issuance of the Commissions' recently released study of unsafe and unsound practices, referred to above. Of equal importance are questions as to the kinds of entities which should be permitted to act as broker-dealers, the kinds of activities in which they should be permitted to engage, the manner in which charges for their services should be determined and the form which payment of such charges should take. All of these issues must be resolved so as to insure that the public can be confident of dealing with an even stronger broker-dealer community capable of reliably performing the services its customers have a right to expect for charges that are fair to all concerned.

In evaluating policy on these matters, there are several critical elements to keep in mind. One is that what is being

bought and sold is a personal service—increasingly, we hope, a professional personal service. A recommendation to buy or sell a security and the execution of most orders of any size require critical elements of responsibility, judgment, skill, experience, knowledge of people and markets, information and research relating to the security. Much of the effort of the industry and the Commission over past years has been to improve the standards of responsibility and professionalism with which brokerage service is made available. Potential savings in the cost of this service are quite small in relation to the amount at stake, well under a penny on a dollar in most cases. We have observed that the cost of this service is frequently considerably lower in relation to commissions prevailing in connection with other forms of investment. We doubt that stock market commissions are significantly higher than any other investment commission, particularly when weighed in the light of the number and the complexity of the elements entering into a sound investment decision and a satisfactory execution with respect to equity securities.

This is not to say that it is not desirable that transaction costs be reduced or that it will not be possible to reduce them. We are hopeful that steps to be taken on competitive rates and on the creation of a modernized nationwide securities transfer system will result in lower transaction costs. But we would be concerned if reduced transaction costs were accomplished at the price of deterioration in standards of service and responsibility, or if apparent reductions in commissions result in higher transaction costs owing to increased spreads and fluctuations, or if investment managers made visible commission cost an exclusive criterion in deciding where to place their executions and ignored, through carelessness or fear of criticism, the elements of skill, knowledge, judgment, and advice. The remaining sections of this statement set forth our views on these and related questions.

Commission Rates

The problems attributable to fixed minimum commission rates on institutional size stock exchange transactions have led to a series of modifications in the commission rate structure during the last few years. Economies of sale were first given recognition in the rate structure on December 5, 1968 when a volume discount was initiated for the portion of orders exceeding 1,000 shares. At the same time, the stock exchanges prohibited so-called customer-directed give-ups, a practice that was producing abuses which it was feared might result in challenges to the very existence of minimum commission rates. Also introduced at that time, at the instance of the New York Stock Exchange, were competively determined rates on very large orders: members were permitted to negotiate with institutional customers in respect of the portion of the commission itself which exceeded $100,000 on a given order. More recently, on April 5, 1971, negotiated rates were introduced into the commission rate structure on the portion of orders exceeding $500,000.

Barriers to full participation in the central market must be eliminated. It should be understood that while the Commission is concerned that the level of commissions be reasonable in all transactions—and particularly in institutional transactions where the difficulties with fixed commissions are most acute—obtaining the best brokerage services, not merely the amount of the commission, must be the ultimate criterion. Our concern with the fixed minimum commission, therefore, is not only with the level of the rate structure but with its side effects as well. Of these, perhaps the most important are the following:

(a) Dispersion of trading in listed securities.

(b) Reciprocal practices of various kinds.

(c) Increasing pressure for exchange membership by institutions.

Fixed minimum commissions, at least on institutional

size orders, may well make it very difficult, if not impossible, to create the central market system we envision. This is true because certain markets and market makers are very likely to choose to stay outside the system in order to compete in service charges as well as in execution, as the third market does, or in order to compete, as certain regional exchanges do, for institutional business by directly or indirectly providing institutions with rebates of commissions.

The fixed minimum commission, as pointed out below, either creates or exacerbates the problem of institutional membership. If competitive commission rates were introduced on most institutional size orders, it appears that most institutions would no longer be interested in membership, except to the extent that some would wish to engage in the general public brokerage business, which would contribute needed capital strength to the industry. We must bear in mind, however, that we are dealing with an industry which has operated under fixed commission rates for a very long time. It is necessary to measure the effect of competitively determined commissions very carefully on a step by step basis. Also, as noted above, the major thrust of broker-dealer reform should be toward upgrading standards of service to the public, including the provision of adequate information, advice, care and responsibility. Any changes in the commission structure should not reverse this process.

The principal argument in favor of fixed minimum commissions is the severe decline in the revenue of the securities industry predicted to result if competitive rates were suddenly introduced on all institutional business. In view of the industry's recent financial crisis and the substantial scars that remain, the possibility of this occurrence is a powerful argument against any precipitous movement to competitive commissions. This would not, however, rule out moving towards competitive rates, at least on large

orders, at a measured, deliberate pace. Given time and a sense of direction, the industry should be able to adjust to this change.

The Commission has cooperated with the NYSE in developing a program to monitor orders which are subject to competitively determined rates. Data received to date indicate that there have been substantial reductions in commissions on the portions of orders exceeding the $500,000 breakpoint. They also suggest that in determining the commission on the "overage" the parties take into account the overall size of the order and the amount of commission attributable to the fixed rate portion of the order.

The Commission is in the process of conducting an inquiry into the impact of competitively determined rates on the markets and market participants. While we have made no final judgment as to the breakpoint at which competitive rates should commence, we believe that at least on large institutional orders the problems engendered by fixed minimum rates can best be resolved by a process of phasing in competitively determined rates. The Commission is aware that further reductions in the breakpoint might have a more severe impact on the income of certain kinds of member firms, on the services they provide, on their role in the capital markets, including the distribution of securities, and on the desires of institutions and their managers to recapture commissions or otherwise use them for their benefit. Indeed, as will be discussed later, the Commission believes that clarification may be necessary in the concept of what services may be paid for by customers by means of commission dollars, both competitively determined and fixed.

Nevertheless, we have determined that a reduction in the breakpoint to $300,000 should take effect in April, 1972, after a year's experience with competitive rates on that portion of an order exceeding $500,000. As noted above,

we have also determined to move toward the point at which commission rates on all orders of institutional size will be, at least in part, subject to competitive rates. The Commission will, of course, continue to observe the experience under the $300,000 level in considering the timing of subsequent steps.

In connection with the subject of commission rates it may be noted that any rate structure is ultimately based upon the cost characteristics of the service being paid for. As stated above, it is to be hoped, and we are optimistic, that current efforts to streamline the clearance function, especially through reduction of the movement of paper in the stock transfer process, will result in significantly lower costs. Similarly, future technological applications may make it possible to automate the execution function as well; the NYSE's experiment with automated round lot execution is an encouraging step in this direction.

Research and Suitability

There can be little doubt that the general availability of information concerning virtually every aspect of the operations and prospects of corporate issuers has been one of the most important elements which has distinguished the American capital markets from all others and which has contributed to their phenomenal growth. Further it is the process broadly referred to as "investment research" which has contributed significantly to unearthing much of this corporate information and sifting, digesting and transmitting it in meaningful form so that it may serve as the basis for market decisions by investors.

It is, therefore, the Commission's premise that broad-based securities research and its prompt and fair dissemination to large and small investors is indispensable to an efficient system of securities markets. We believe that

a broker is obliged to communicate any material changes in his prior investment advice arising from subsequent research he may do to all customers whom he knows have purchased and may be holding shares on the basis of his earlier advice, at least under circumstances where to do so would not impose an unreasonable hardship on the broker.

It is also essential that, regardless of what level of competitively determined commission rates may be determined to be appropriate, the viability of the process by which research is produced and disseminated not be impaired. Presently, many institutions compensate brokers for research by allocation of commission business. If fixed minimum commissions were no longer to be applicable to institutional size transactions, an "unbundling" process might result so that some brokers would charge separate fees for services such as execution, research and the like. Nevertheless, brokers who do in-depth research might prefer to charge higher commissions than other brokers whose research activity is narrower in scope or of lesser quality or value. Concern has been voiced that under such circumstances insitutional managers charged with a fiduciary duty would be reluctant to pay a higher commission rate which reflected research. The Commission believes that they should not be. In our opinion, the providing of investment research is a fundamental element of the brokerage function for which the bona fide expenditure of the beneficiary's funds is completely appropriate, whether in the form of higher commissions or outright cash payments. It should be disclosed to investors that their money manager is willing to exercise discretion in seeking the best information and research available and does not consider that there is an obligation to get the cheapest execution regardless of qualitative consideration. It should of course be expected that managers paying

brokers for research with their beneficiaries' commissions or other funds would stand ready to demonstrate that such expenditures were bona fide.

Concern has also been expressed that under an unbundled rate system many small investors would seek to obtain the lowest rates available and would lose the benefit of basic research now paid for by the minimum commission. In this regard, the Commission wishes to emphasize that a broker-dealer will not be relieved of his obligation to his customer with respect to the "suitability" of a securities transaction.

It should be noted that the suitability rules are cast in terms of the needs of the customer based on information he furnishes to the broker. Unarticulated but implicit in such rules is also the broker's obligation to obtain current basic information regarding the security and then to make an evaluation as to the suitability of a recommendation for a particular customer in view of both the information concerning the security and the customer's needs.

The Commission recognizes that some customers will independently determine to purchase or sell specific securities and will not request or desire the advice of a broker and that in these circumstances it is impractical to require rigid adherence to the suitability rules. Even in such cases, however, the broker would appear to be obliged to reveal to the customer information known to him about the security which might reasonably be expected to affect the customers' decision, apart from his other duties under applicable provisions of the securities laws.

Vigorous enforcement of the standards of suitability discussed above would thus mean that as competitive commission rates are introduced the basic execution charge which would evolve would include the provision of research services to the extent necessary to comply with these standards.

Reciprocal Portfolio Brokerage for Sales of Investment Company Shares

The Commission and other persons interested in the securities industry have a number of years been seriously concerned about the widespread practice of investment company managers using portfolio brokerage of mutual funds to reward broker-dealers for sales of fund shares. This practice Was examined by the Commission in its Special Study of Securities Markets (1963), its Report on the Public Policy Implications of Investment Company Growth (1966) and the Institutional Investor Study. Several Committees of the NASD have also addressed themselves to this practice.

The regulatory problems related to the reciprocal use of portfolio brokerage, as noted in these studies, are at least fivefod. First, the practice contains the danger that the retail seller of a mutual fund will be unduly influenced to base his recommendation to his customer on the amount of additional rewards he receives in terms of portfolio brokerage commissions rather than upon the investment needs of his customers. In fact, industry leaders have found that this danger is very real in the case of other rewards that are given, over and above the ordinary fund dealer concession. They have found this to be true even where this additional source of dealer compensation is disclosed to the customer. These abuses have led the NASD to limit or prohibit certain kinds of supplementary rewards in its Special Deals Interpretation.

Second, fund managers may be tempted to engage in various types of improper portfolio practices at the expense of fund shareholders. The competitive need to allocate portfolio brokerage commissions to fund sellers may exert pressures for frequent sales and purchases of fund portfolio securities unwarranted by sound investment considerations. Such pressures on fund managements may also result in the selection of firms to handle portfolio

executions that are not necessarily in a position to obtain the best prices.

Third, the Commission's studies have reiterated the point that this form of reciprocity has serious anticompetitive impacts. The use of portfolio brokerage to reward dealers who sell investment company shares places small investment companies and complexes, which cannot allocate as much brokerage for sales as larger ones, at a distinct competitive disadvantage because the NASD's Special Deals Interpretation is not applied to reciprocal brokerage but is applied to prohibit managements from rewarding fund sellers in other ways.

Fourth, we believe that the cost of selling and purchasing mutual fund shares should be borne by the investors who purchase them and thus presumably receive the benefits of the investment, and not, even in part, by the existing shareholders of the fund who often derive little or no benefit from the sale of new shares. To impose a portion of the selling cost upon the existing shareholders of the fund may violate principles of fairness which are at least implicit in the Investment Company Act.

Finally, the practice of compensating broker-dealers for mutual fund sales by assigning them commission business violates the long accepted precept in investment company regulation that an investor is entitled to know how much was paid to those who sell him an investment. This practice puts the investment company in the position of issuing a prospectus which purports to specify the sales compensation but fails to quantify the additional compensation paid to the customer's broker-dealer in the form of commission business awarded on the basis of success in selling investment company shares.

The Commission believes it should be made clear now that these reciprocal practices must be terminated. When the NASD completes its study of what it considers to be a fair load for the sale of investment company shares, as

required by the Investment Company Amendments Act of 1970, it will be in a position to recommend a sales charge which reflects the full incentive appropriate to such sales and which can be fully and explicitly disclosed to the buyers of such shares. To accomplish this the Commission is sending a letter to the NASD setting forth the Commission's views and requesting the NASD to direct its members to discontinue the use of reciprocal portfolio brokerage for the sale of investment company shares. If such a response is not worthcoming, the Commission will then consider rule-making to accomplish the desired result.

Institutional Membership

The question of institutional membership on national securities exchanges is an exceedingly difficult one, and in dealing with it we have painstakingly reviewed the alternatives presented ot us. It is the Commission's firm view that, as a central market system develops, it should have at its heart a corps of professional brokers and market makers serving investors. Moreover, in light of the strain which the magnitude and tempo of the transactions of financial institutions currently place on the securities markets, it is our view that institutions should not be permitted to deal through brokerage firms established principally to handle their own transactions but should be required to deal through brokers dedicated primarily to serving and having fiduciary obligations to a broad investing public. Thus, as a general rule, the Commission believes that membership in the central market system should be open only to those who meet qualifying standards and who have the primary purpose of serving the public as brokers or market-makers.

We should begin with definitions. The term "institutional membership" has not been clearly defined, with the result that discussion of this issue, both in terms of public policy and in terms of where responsibility for deciding the fundamental question is lodged, has been enveloped in a definitional fog. For this purpose, we define

institutions to include banks, pension and other employee benefit funds, investment companies (including their advisers) and insurance companies.

There are several varieties of institutional membership. There is, first, the situation which exists on several regional exchanges in which an institution creates a subsidiary which does no brokerage business with the public, but rather exists primarily as a vehicle to obtain rebates of commissions for its parents. Such a subsidiary does not actively participate in stock exchange transactions for its parent. Rather it refers its parent's order to, or is approached by, a member of the New York Stock Exchange which is also a member of the particular regional exchange (a so-called "dual member"). The dual member executes the transaction in the primary market and then, using long established access techniques for sole members of regional exchanges, reciprocates to the subsidiary of the institution commissions on unrelated transactions. The subsidiary, in turn, rebates all or part of these sums to its parent or its affiliates.

A second situation included within the concept of institutional membership is that where an institution establishes or acquires a broker-dealer which does business for the general public and may also execute some transactions for its parent.

There is also the situation where an existing member firm of an exchange does predominantly a public brokerage business but also, directly or through affiliates and subsidiaries, managers investment companies, pension and employee benefit funds and other institutional portfolios, and in connection therewith may perform brokerage functions for these managed funds and accounts.

Certain regulatory problems arise out of the relationships created by institutional membership. The first stems from the existence of a structure of fixed minimum

commissions. So long as such a structure exists, large investors should not, by virtue of their economic power and size, be entitled to obtain rebates of commissions not available to other investors. While fixed minimum commissions exist, they should apply to all investors, and an exception should not be given to a particular person. Institutional membership, however, provides a vehicle for obtaining rebates, either directly or indirectly.

Second, institutional membership may result, to a greater or lesser degree depending on the circumstances, in the use of exchange membership for private purposes rather than for the purpose of serving the public in an agency capacity or otherwise performing a useful market function. In part, this problem is similar to that discussed in the preceding paragraph: the problem of using exchange membership as a means of obtaining a reduced commission rate. But the problem of using exchange facilities for private purposes is broader in scope than the rate question. For we believe that membership in the market system should be confined to firms whose primary purpose is to serve the public as brokers or market makers. Stock exchanges are affected with an overriding national interest which demands that they act to maintain and improve the public's confidence that the exchange markets are operated fairly and openly. The public should have the assuarnce that a member of an exchange is dedicated to serving the public, and membership by institutions not predominantly serving non-affiliated customers should not be permitted to cloud this objective.

Our authority to deal with these problems derives from the stated purposes of the Securities Exchange Act and is most specifically expressed in Section 19(b) of such Act which deals with "such matters as . . . the fixing of reasonable rates of commission, interest, listing, and other charges . . . and . . . similar matters".

Insofar as institutional membership is employed

primarily as a vehicle for obtaining recapture of commissions, as in the first situation described above, it should not be allowed to exist. Membership under those circumstances is plainly in conflict with the concept of fixed minimum commissions and results in exchange membership solely for private purposes. We believe that such membership and practices which permit the rebate or recapture of commissions, directly or indirectly, should be eliminated. The Commission intends to act promptly to terminate this type of membership. The regional exchanges, as vital elements of the central market system, should compete on their merits as market components and should not need this special competitive tool.

With respect to the second situation—where an institution establishes or acquires a broker-dealer doing business for the general public—we perceive no reason either of law or policy why this should not be permitted. The establishment of such a subsidiary doing a brokerage business for the public provides a useful source of permanent capital for the securities industry. This necessarily implies elimination of the so-called "parent test". The question then is whether, assuming that such a subsidiary does business predominantly with public investors, it should also be allowed to execute some transactions for its parent institution as an incident to that public business.

Before discussing this aspect of the second described situation it is useful to examine the third situation—that of an existing member firm doing predominantly a public brokerage business and also engaging in money management and performing brokerage for the accounts which it manages. Such relationships have long been the practice in the securities industry, although they too can result in avoidance of the fixed commission structure for certain investors. Moreover, if it were to be concluded that it is improper for a member firm to execute transactions for accounts which it manages, it would logically follow that it

could not execute transactions for its own account (except in the performance of market functions, such as those of a specialist, block trader or arbitrageur). But it has also long been the practice in the securities industry for member firms to execute transactions for their own account. In view of the long-standing nature of these relationships and practices, we believe that a prohibition against a member firm of an exchange executing transactions, either for accounts which it manages or for its own account, would be a precipitate measure, the full consequence of which might not be foreseeable at this time. We also believe that those members of the investing public who invest directly rather than through institutions are in need of additional money management services and that the experience member firms have accumulated in the area of money management can be valuable in meeting this need. Finally, we think it important that a portion of broker-dealer income be based on a more stable source than commission business.

Returning to the second type of institutional membership, we believe that so long as member firms are permitted to transact a portion of their commission business for their own and managed accounts, it would be inappropriate to impose an absolute restriction prohibiting an affiliate of an institution from conducting any commission business on behalf of its institutional affiliate.

We should elaborate on why the Commission is unable at this time to reach the conclusion that firms affiliated with institutions should be flatly prohibited from executing transactions for those institutions. We are constrained by considerations of economic impact and of fairness as between brokerage firms created by institutions and brokerage firms which themselves have created institutions. In addition, we are mindful of the fact that Congress has had occasion to review the investment company—broker relationship and has not abolished it.

Congress in 1934 mandated a review by the Commission

of whether the functions of broker and dealer should be separated, and at that time the Commission found that, on balance, it should not. Furthermore, in enacting the Investment Company Act Congress apparently did not find it necessary that the brokerage and investment company functions be completely separated. There are potential conflicts of interest in these relationships, as well as in the broker-underwriter relationship, the money manage-underwriter relationship and the dealer-money manager relationship. If all of these functions were to be separated, the capital-raising capability of the industry and its ability to serve the public could be significantly weakened. We therefore believe that the conflict of interest problem which is inherent in the combination of money management and brokerage is a matter to be resolved by Congress. Only that body should decide whether or not this potential conflict can continue to be dealt with in the same manner as the other conflicts mentioned above, by a combination of disclosure and enforcement of fiduciary obligations, or whether it is sufficiently troublesome to require separation of the two functions.

In view of these principles, we believe that all exchange members should be required to engage in a bona fide public brokerage business, except insofar as they perform a recognized market function such as that of a specialist. Precise definition of what constitutes a bona fide public brokerage business is a matter on which we will seek the advice of the self-regulatory bodies and other interested persons. We believe that concept and its definition also warrant the attention of Congress. However, it is our view that any brokerage firm which is not doing a predominant portion of its brokerage commission business for non-affiliated persons should not be considered to be conducting a public brokerage business. Predominant means to us significantly more than half. Non-affiliated persons include individual discretionary and non-discretionary accounts and the accounts of non-affiliated institutions,

but do not include institutional parents or investment companies or other institutional funds which are managed under contracts or arrangements which give the brokerage firm investment discretion. The Commission will formally request the stock exchange to adopt uniform rules restricting membership to firms which do such a public brokerage business. If any stock exchange does not adopt such rules, we will then determine whether we should require this action or whether we should request appropriate legislation from Congress.

This qualification on institutional membership of any kind should ensure that exchange membership is utilized by broker-dealers engaged in a public brokerage business and that the opportunity to secure commission rebates is circumscribed to the greatest extent possible, consistent with minimum disruption in existing methods of doing business.

Under the system we have described, broker-dealers will remain able to diversify their business so that more stable money management income will increasingly balance off fluctuating brokerage income, and their brokerage customers will not be deprived of their money management experience. On the other hand, institutions will have an opportunity to diversify by entering the public brokerage business, thus providing needed new capital in that sector.

It is also appropriate to note concern has been expressed that direct or indirect reciprocal arrangements may be devised and utilized to avoid the thrust of any attempt to control or regulate institutional membership. We wish to caution those considering this course that if this should occur it is our intention to adopt or require the adoption of and to enforce vigorously appropriate rules prohibiting such arrangements.

In view of the increasing internationalization of securities transactions, it is relevant to a discussion of exchange membership to consider whether brokers con-

ducting a public business but controlled or owned by foreign entities should be permitted to become members of our exchanges. We believe that this question should be resolved in the context of reciprocal access to foreign securities exchanges, with the goal of open access under equivalent competitive conditions for all qualified brokers of all nations.

IMPLEMENTATION

To further develop and carry out the policies outlined in this statement, the following steps, among others, appear necessary:

1. The Commission will designate a working committee to continue the work of the committee constituted by the exchanges to study the development of the comprehensive market disclosure system. It is contemplated that this committee would be made up of the members of the existing committee, plus certain additional members, including Commission personnel, and that it would present to the Commission within 90 days of its formation specific recommendations on the information to be disclosed by the system and the technological means for accomplishing this disclosure, together with an analysis of the relevant economic considerations. Meanwhile, the Commission will take action to require that all exchanges and third market firms report volume and range of prices in all their transactions in listed securities on a daily basis.

2. A working committee will be appointed to study and report on the structure, regulation and governance of a central market system, including rules to regulate the activities of competing market makers and to effectively integrate the over-the-counter market in listed securities with the exchange markets.

3. A working committee will be appointed to study and propose necessary and desirable rules to ease the impact and improve the handling of large blocks.

4. Within the next 90 days the Commission will act to reduce the level at which commission rates are competitively determined down to $300,000.

5. The Commission is writing to the NASD to direct the formulation and implementation of rules terminating the practice of placing an investment company's portfolio executions with broker-dealer in consideration of their sales of that investment company's shares.

6. The Commission will promptly request all exchanges to adopt rules excluding from membership any organization whose primary function is to route orders for the purpose of rebating or recapturing commissions, directly or indirectly, in any manner or form.

7. The Commission will promptly consult with all exchanges and other interested persons in order to formulate exchange rules requiring that members engage in a brokerage business, as measured by doing a predominant part of their brokerage commission business with non-affiliated customers. These consultations will lead to a future determination as to whether implementation of this step requires Congressional action.

CONCLUSION

This Statement of Policy reflects the Commission's present evaluation of the structure and operation of the securities markets and of the industry which serves those markets. In formulating proposals to deal with the deficiencies that have been observed, the Commission recognizes that the fundamental objectives encompassed by its statutory mandate—including the protection of in-

vestors, fair dealing in securities, fair administration of the self-regulatory organizations, the prevention of fraudulent and manipulative acts and practices and the promotion of just and equitable principles of trade—may require the consideration of a broad range of regulatory alternatives for their fulfillment. As the securities markets continue to change, so must the Commission continually direct its attention to regulatory alternatives responsive to such changes.

In setting out our view of the directions in which the industry must move, we believe we have outlined the structure of a marketplace which will serve the nation well in the future. Yet we recognize that the task ahead is enormous and requires that others join us in our efforts and build upon the foundation we have sought to lay. Despite the labors which achievement of our goals will require, we can take comfort in the knowledge that if we are successful, as we believe we will be, the benefits which derive from our joint undertaking will be shared by many: the investing public, the securities industry, the financial services industry, the multitude of business enterprises with their insatiable appetite for capital and the economy as a whole.

* * *

COMMISSIONER OWENS DISSENTING IN PART:

I concur in all respects with the stand of my colleagues in the Statement of the Future Structure of the Securities Markets except that I cannot agree with their conclusions regarding institutional membership and the related issues of institutional management and brokerage (page 20, et. seq.).

Before coming to the precise point of disagreement, I should like to say that under our American system of free enterprise any legally organized institution[1] should be permitted to invest in a broker-dealer subsidiary or affiliate and that that entity should be allowed entry to the exchanges, provided, of course, that it is adequately capitalized and otherwise qualified I further believe, however, and it it here that I disagree with my colleagues, that such affiliated broker-dealer should be required to do exclusively a public business and should be prohibited from engaging in any securities transactions with its parent or affiliate. The justification or rationale for such denial is that securities transactions in such a relationship permit of a rebate situation, either directly or indirectly. The granting of rebates is, of course, always damaging to the integrity of the securities industry and to the welfare of the general public which it serves; its deleterious effects cannot be cured by prohibiting exchange memberships sought primarily for the purpose of rebating or by requiring that members do a predominant part of their listed commission business with non-affiliated customers. Such restrictions, which are those advocated by my colleagues, do not prohibit rebates. They only limit the portion of the members' business which can be done on behalf of institutional affiliates and, thus, in effect, sanction limited

1. For the purpose of this discussion, institutions will be defined as banks, pension and other trust funds, insurance companies and investment companies.

rebates.

The Commission could implement the prohibition I advocate her pursuant to the legal authority presently vested in us by Section 19(b) of the Securities Exchange Act of 1934. That section authorizes the Commission, following certain procedures described therein, to alter or supplement the rules of a national securities exchange with respect to, among other matters, the fixing of reasonable rates of commission. Rebating is, by its very definition, a practice which impinges directly upon the effectiveness of the prescribed minimum commission rates.

Not only do I think it is bad for an institution to do business on an exchange through the medium of a broker-dealer affiliate which it controls, but on the other side of the coin, I think that the practice of a broker-dealer performing portfolio brokerage services for institutional accounts which it manages, either directly or indirectly, should likewise be prohibited. I would not include in this category individual discretionary accounts or those belonging to the broker-dealer firm itself or its principals.

The difficulty in regard to implementing this prohibition, however, is that the giving of rebates is not involved, as I see it, and we, consequently, would not have the legal authority to act administratively against this type of operation as we do in the case of the institutionally dominated broker-dealers. I would, therefore, propose that the Commission formally request the stock exchanges to adopt uniform rules prohibiting firms which manage institutional accounts from acting as brokers for those same accounts. If the stock exchanges were not willing to adopt such rules, then I would propose that the Commission petition the Congress to enact legislation to accomplish this objective.

LETTER DATED MARCH 17, 1972

NEW YORK STOCK EXCHANGE
Department of Member Firms
4 New York Plaza
At Broad and Water Streets
New York, N.Y. 10004

March 17, 1972

Mr. Irving M. Pollack
Division of Trading and Markets
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Mr. Pollack:

Pursuant to SEC Rule 17a-8 under the Securities Exchange Act of 1934, we are submitting herewith three copies of proposed amendments to Sections (2) and (4) of Article XV of the Exchange Constitution which was laid on the table and approved in principle by our Board at their meeting on March 16, 1972, and which will be presented to the Board for submission to the membership for vote on March 30. We, therefore, request your accelerated consideration of these amendments and would appreciate receiving your comments as soon as possible.

The proposed amendments would put into effect the changes requested in the Commission's Statement on the Future Structure of Securities Markets of February 2 and Mr. Casey's letter to Mr. Haack of February 9.

Sincerely,

Enc.
cc: Mr. William Painter
Subcommittee on Commerce
and Finance

PROPOSED AMENDMENTS OF SECTIONS (2) AND (4) OF ARTICLE XV

New language underscored.

Delete language in brackets [ ].

(1) Amend Section 2(a) of Article XV which relates to the commission to be charged non-members as follows:

(a) On that portion of an order involving an amount of [$500,000] *$300,000* or less, on business for non-members and allied members, including joint account transactions in which any such person is interested.

* * *

(2) Amend Section 2(a)(2) of Article XV relating to non-member rates on multiple round lot orders as follows:

(2) On each multiple round lot order for 200 shares or more, commissions shall be based upon the amount involved in the order and shall not be less than the rates hereinafter specified:

Amount Involved in the Order	Minimum Commission
$ 100-but under $ 2,500	1.3% of money involved + $ 12.00
$ 2,500-but under $20,000	0.9% of money involved + $ 22.00
$20,000-but under $30,000	0.6% of money involved + $ 82.00
$30,000-to and including [$500,000] *$300,000*	0.4% of money involved + $142.00

Plus a charge for each round lot of 100 shares within the order as follows:

First to tenth round lot	$6.00 per round lot
Eleventh round lot and above	$4.00 per round lot

Notwithstanding the foregoing:

(i) When the amount involved in an order is less than $100, the minimum commission shall be as mutually agreed.

(ii) The minimum commission per round lot shall not exceed the single round lot commission computed in accordance with the provisions of paragraph 2(a)(1).

(3) Amend Section 2(a)(4) of Article XV relating to the commission to be charged non-members with respect to stocks selling below $1.00 per share as follows:

(4) On that portion of an order involving an amount of [$500,000] *$300,000* or less, on stocks selling below $1.00 per share, commissions shall be based upon the amount involved in the order and shall not be less than the rates hereinafter specified:

* * *

(4) Amend Section 2(b) of Article XV relating to intra-member rates for floor brokerage and clearance to read as follows:

(b) On that portion of an order involving an amount of [$500,000] *$300,000* or less, on business for members of the Exchange when a principal is not given up, commissions shall be based on the number and price of shares in the order as follows:

* * *

(5) Amend Section 2(c) of Article XV relating to intra-member rates for floor brokerage as follows:

(c) On that portion of an order involving an amount of [$500,000] *$300,000* or less, on business for members of the Exchange when a principal is given up, commissions shall be based on the number and price of shares in the order as follows:

* * *

(6) Amend Section 2(f) of Article XV to read as follows:

(f) Notwithstanding the rates prescribed in paragraphs 2(a)(1) and 2(a)(2), when the amount involved in an order exceeds [$500,000] *$300,000* the minimum commission to be charged pursuant to those paragraphs shall apply to the maximum number of round lot transactions involving an aggregate amount not in excess of [$500,000] *$300,000*. The Exchange shall from time to time prescribe the procedures to be followed in computing commissions pursuant to this Article.

(7) Amend Section 4(c) of Article XV which relates to clearing charges on proprietary transactions as follows:

(c) Where the purchase or sale is made at one time from a single seller or buyer and involves an amount in excess of [$500,000] *$300,000*, the rates specified above shall apply only with respect to that portion of such purchase or sale not in excess of [$500,000] *$300,000*.

LETTER DATED MARCH 23, 1972

NEW YORK STOCK EXCHANGE

March 23, 1972

The Honorable William J. Casey, Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Casey:

We have your letter of March 9 asking that each exchange begin to draft rule changes to implement the Commission's decision that the level at which commission rates may be negotiated be reduced to $300,000 effective in April 1972.

On March 17 a proposed change in the Exchange's Constitution reducing the breakpoint to $300,000 was submitted to Mr. Irving Pollack pursuant to Commission Rule 17(a)8.

This action was taken at the Pulley meeting of the Exchange's Board of Governors on March 16, at which time the Board also decided, as reported in the enclosed press release of that date, " . . . that it will continue to closely monitor the impact of negotiated rates at the $300,000 level as was done at the $500,000 level. In six months following the effectiveness of the $300,000 level, the Board plans to again review the level. Depending upon the results of the monitoring data at the time of that review, the Board may recommend a change in the level at which commission rates may be negotiated."

This action was taken in accordance with the timetable whith the Board intends to follow which envisions final action by the Board of Governors at its March 30 meeting and submission of the proposal to the membership for balloting to be concluded by April 12. Assuming a

favorable vote of the membership, the amendment providing for negotiated rates on that portion of an order in excess of $300,000 would become effective April 24, i.e. for transactions cleared beginning May 1.

We hope that this action and timetable is consistent with the Commission's request, as stated in your letter of March 9.

Your letter of March 9 also asks the exchanges to "make any rule changes necessary to enable it to comply promptly with such (future) requests" for further reductions in the breakpoint. We have reviewed whether any such rule changes are necessary and concluded that they are not.

A year ago, prior to the adoption of the Constitutional amendment providing for negotiated rates at the $500,000 level, the Board of Governors, with Commission acquiescence, repealed Exchange Rule 26 which was adopted around 1958 following the last commission rate changes and required, in effect, a lapse of 30 days before the Exchange made any changes in commission rates.

Under present Constitutional procedures (Article XX), an amendment to the Exchange Constitution must be laid upon the table, i.e. posted, for a minimum period of two weeks prior to approval by the Board for balloting by the membership. Balloting is to be open for a minimum period of ten days. Accordingly, it is possible under existing procedures to amend the Exchange Constitution in 24 days, i.e. 14 days posting and 10 days balloting.

This time frame does not take into account the Commission's Rule 17(a)8 which requires three weeks notice of any proposed changes nor does it reflect the need to make commission rate changes effective at a time which accommodates member firm operations and clearing procedures.

Sincerely,

(signed) Robert W. Haack

Encl.
RWH:DLC:ek

NEW YORK STOCK EXCHANGE
NEWS BUREAU

For Immediate Release, Thursday, March 16, 1972

NYSE BOARD ACTION ON NEGOTIATED FEES

The Board of Governors of the New York Stock Exchange, InNc. has given preliminary approval to a Constitutional amendment which would permit commissions to be negotiated on portions of orders in excess of $300,000, the Big Board announced today.

At the same time, the Board made the following policy statement: "In considering the question of the appropriate level at which commission rates may be negotiated the Board of Governors has determined that it will continue to closely monitor the impact of negotiated rates at the $300,000 level as was done at the $500,000 level. IN six months following the effectiveness of the $300,000 level, the Board plans to again review the level. Depending upon the results of the monitoring data at the time of that review, the Board may recommend a change in the level at which commission rates may be negotiated."

Commissions on portions of orders over $500,000 have been negotiated since April 5, 1971, with rates being fixed on orders under $500,000.

Board action on the proposed amendment follows an SEC announcement in February that a reduction in the negotiated commission level to $300,000 should take effect in April, 1972.

Analysis Due

Exchange President Robert W. Haack noted that a detailed analysis of the impact of negotiated rates over the past 11 months is to be completed by March 30.

"ASsuming that this analysis does not reveal any unfavorable factors of which we are not now cognizant," Mr. Haack said, "we would ask the Board to approve for-

warding the amendment to the Exchange membership for balloting."

A study of negotiated rates for the second and third quarters of 1971 showed that brokerage firm revenues were reduced by an estimated $31.4 million, when compared to what commissions would have been under the previous fixed schedule.

Setting forth a projected timetable, Mr. Haack said that members could vote on the proposed amendment on April 12. If there was a favorable vote for the amendment, negotiated rates on that portion of any order over $300,000 would become effective for trades made on April 24, he added.

LETTER DATED MARCH 9, 1972

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

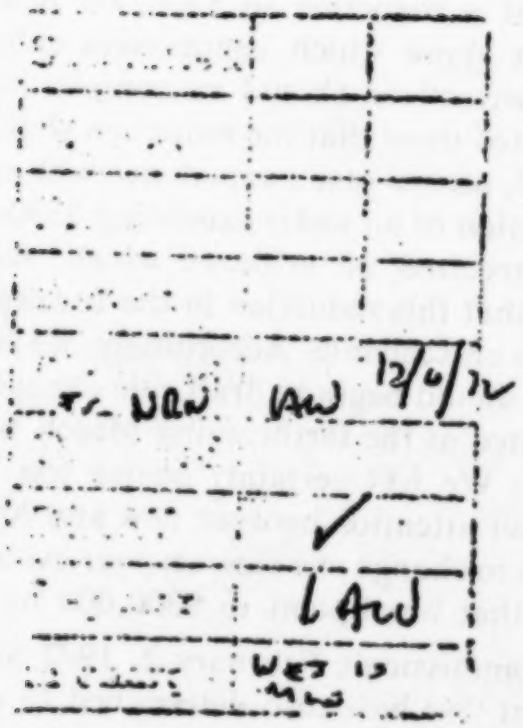
As you know, the Commission's February 2 Statement on The Future Structure of the Securities Markets concluded that a reduction to $300,000 is indicated in the breakpoint above which commission rates on stock exchange transactions should be competitively determined. We indicated there that the reduction should take effect in April 1972, after a year's experience with competitive rates on the portion of an order exceeding $500,000. Since then we have received no evidence which would lead us to conclude that this reduction in the breakpoint should not take place on schedule. Accordingly, we believe that each exchange should begin to draft rule changes which may be implemented at the forthcoming March policy meeting of its Board. We will certainly advise you should evidence come to our attention between now and April which would require us to change our view on your exchange proceeding to lower that breakpoint to $300,000 by April.

The Commission's February 2, 1972 Statement further stated that "we have also determined to move toward the point at which commission rates on all orders of institutional size will be, at least in part, subject to competitive rates." In view of the possibility of future Commission requests for further reductions in the breakpoint level, your exchange should at this time make any rule

changes necessary to enable it to comply promptly with such requests.

Sincerely,

William J. Casey
Chairman



AFFIRMATION OF I. WALTON BADER IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS OR FOR SUMMARY JUDGMENT

(SAME TITLE)

I, WALTON BADER, a member of the Bar of the State of New York, hereby states the following under penalties of perjury.

I am one of the attorneys for the plaintiffs herein and am fully familiar with the facts and circumstances of this action.

This suit, a Class Action, has been brought against the defendant exchanges and representative brokers for damages with respect to the following practices:

a. The Rules of the defendant Stock Exchanges which set minimum commission charges and provide penalties for brokers charging less than the stipulated minimums (although charges in excess of the minimums are permitted).

b. The Rules of the defendant Stock Exchanges which provide for limited access to the facilities of the Exchanges and, in effect, provide for access to such facilities only through "members".

c. The Rules of the defendant Stock Exchanges which limit the number of "members" and which, by reason thereof, make "seats" on the defendant Exchanges costly and beyond the reach of many potential competitors.

d. The Rules of the defendant Stock Exchanges that provide for negotiated commission rates on trades in excess of Three Hundred Thousand ($300,000) Dollars but fixed rates on trades for lower amounts.

e. The Rules of the defendant Stock Exchanges that provide for a discount on trades in excess of

100 shares and a higher commission for trades less than 1000 shares.

f. The Rules of the defendant Stock Exchange, in effect from April 6, 1970 to March 24, 1972 relating to the imposition of an "interim service charge" on trades of less than 1000 shares of stock.

By stipulation the plaintiff's motion that this suit be treated as a Class Action has been deferred pending the disposition of the defendants' motion to dismiss and for summary judgment.

The defendants, in this suit, claim that the Commission Rates involved have been *approved* by the Securities and Exchange Commission. Annexed to this affidavit are briefs of the Securities and Exchange Commission submitted on motions to dismiss the actions brought by the plaintiffs against that agency with respect to the same issues as involved in this suit. As can be seen from these briefs which set forth the position of the Securities and Exchange Commission, the Commission *denies* that it has approved any rates or that it has the power to do so. The Commission also suggests that the legality of the rate structure involved be determined in this action.

This being a motion for Summary Judgment all that the plaintiff need show is a "triable issue of fact". It is not necessary on this motion, to *prove* that the questioned practices are in violation of law. Suffice it to say that there has even been action taken against the Bar Association "minimum fee schedules" where the Bar Associations have no power to enforce their fee suggestions. Various Commodity Exchanges (not regulated by the SEC) have removed minimum commission rates from their Rules after anti-trust attack.

In the Case at Bar the fixed commission rates of the defendant Stock Exchanges would, if not for the claimed SEC regulation, be a clear violation of Section 1 of the Sherman Anti-Trust Act as constituting a "price fixing"

conspiracy. Indeed, since the defendant Exchanges provide for *penalties* for violation of these Rules, the illegal nature of this action is almost *prima facie* established. The affidavit of RICHARD A. GORDON clearly shows that it would be possible, if not for the acts of the defendant Exchanges, to obtain a lower rate of commission from brokers.

Granting price concessions on large trades and price surcharges on small trades are violations of the Robinson-Patman Act (at least prima facie). The affidavit of RICHARD A. GORDON shows that small trades are not, as claimed by the defendant exchanges, more expensive than large trades but, as a matter of fact, the reverse is true.

Providing for limited memberships in a body and excluding outsiders where the body is the only means for carrying out certain activities is likewise a clear violation of anti-trust rules.

Forbidding outsiders to use facilities which constitute the only method of doing business is likewise a violation of anti-trust rules.

The sole defense urged by the defendant Exchanges (despite the voluminous papers submitted) lies in the claim that these Exchanges are "regulated" by the Securities and Exchange Commission and that this Commission has "approved" the rates and practices involved. This is just not true and the briefs of the Securities and Exchange Commission annexed to this affidavit prove it. The defendant Exchanges have, for a long time, been "lobbying" Congress to make the Stock Exchanges fully regulated organizations similar to the regulation imposed on the airlines by the Civil Aeronautics Board, on the Railroads by the Interstate Commerce Commission, etc. Congress has not, up to this time, given the Securities and Exchange Commission such regulatory power. It is true that, in certain cases, the Securities and Exchange

Commission can determine rates and practces to be put into effect by the defendant Exchanges. However, this requires Notice, hearings, Court Review, etc.which has not been had in this case.

The plaintiffs, in this case, have been adversely affected by the practices complained of herein as set forth in detail in the GORDON affidavit and therefore have standing to question the practices involved. Also, as indicated in the GORDON affidavit, the Securities and Exchange Commission has, itself, indicated that it has not approved the practices involved and successfully dismissed Judicial Review of the actions involved on that ground.

WHEREFORE the undersigned prays that the defendants' motion be in all respects denied.

s/I. Walton Bader
I. Walton Bader

Sworn to
February 16th, 1973

AFFIDAVIT OF RICHARD A. GORDON IN OPPOSITION TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

(SAME TITLE)

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

RICHARD A. GORDON, being duly sworn, deposes and says:

I am the President of the INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an Unincorporated Association, which maintains an office and place of business at 19 West 24th Street, New York, N.Y.

My brother, FRANK GORDON, is also a Member of the INDEPENDENT INVESTOR PROTECTIVE LEAGUE.

The INDEPENDENT INVESTOR PROTECTIVE LEAGUE is an Organization of investors, in securities listed on the New York Stock Exchange and the American Stock Exchange. Members of the INDEPENDENT INVESTOR PROTECTIVE LEAGUE, including my brother and myself, have utilized the services of one, or more, of the brokerage firms who are Members of the New York Stock Exchange and the American Stock Exchange.

Mr. Frank Gordon and myself, as tenants in common, have conducted the following trades in listed securities (as annexed hereto):

YEAR	BOUGHT OR SOLD	NO. OF SHARES	NAMES OF SECURITY	COMMISSION PAID	DATE OF TRANSACTION
1968	B	300	REEVES INDUSTRIES	26.26	June 6, 1968
1968	B	200	GRUEN INDUSTRIES	32.76	July 15, 1968
1968	B	200	GRUEN INDUSTRIES	38.00	Sept. 27, 1968
1969	B	200	INDUSTRIAL ELEC. HARD.	26.76	March 10, 1969
1969	B	100	STANDARD PRUDENTIAL CORP.	27.50	Aug. 8, 1969
1969	B	100	UNION OIL COMPANY	45.83	Aug. 8, 1969
1969	B	100	HOLDAILLE INDUS.	37.50	Aug. 8, 1969
1969	B	100	INSILCO CORP.	31.50	Aug. 11, 1969
1969	B	100	TWENTIETH CENTURY FOX FILM	26.25	Aug. 8, 1969
1969	B	100	INSILCO CORP.	31.50	Aug. 8, 1969
1969	B	100	ENGELHARD MINERALS & CHEM.	51.65	Aug. 21, 1969
1969	B	100	SUNSTRAND CORP.	44.20	Aug. 21, 1969
1969	B	200	DRESSER INDUSTRIES INC.	75.26	Aug. 21, 1969
1969	B	100	BENEFICIAL FINANCE CO..	46.35	Aug. 22, 1969
1969	B	100	MEAD CORP.	46.63	Aug. 25, 1969
1969	B	100	CROWN CORK & SEAL	23.75	Dec. 29, 1969
1969	B	100	CROWN CORK & SEAL	23.63	Dec. 8, 1969
1969	B	100	BENEFICIAL FIN. CO.	44.15	Dec. 2, 1969
1969	S	200	CITY INVESTING CO.	88.00	Nov. 17, 1969
1969	S	200	BUNKER RAMO CORP.	81.62	Nov. 11, 1969
1969	B	200	ELGIN NATIONAL INDUSTRIES	29.76	Dec. 19, 1969
1969	B	100	FILTROL CORP.	35.50	Oct. 20, 1969
1969	S	100	STANDARD PRUDENTIAL	29.50	Oct. 20, 1969
1969	B	100	NATIONAL GENERAL CORP.	28.63	Oct. 29, 1969

YEAR	BOUGHT OR SOLD	NUMBER OF SHARES	NAME OF SECURITY	COMMISSION PAID	DATE OF TRANSACTION
1969	B	100	WHITE CONSOLIDATED IND.	26.13	Sept. 29, 1969
1969	S	300	TWENTIETH CENTURY FOX	78.00	Nov. 21, 1969
1970	B	100	OCCIDENTAL PETROLEUM	31.63	Jan. 15, 1970
1969	S	100	UNION OIL CO. OF CALIF.	43.88	Dec. 31, 1969
1970	S	100	FILTROL CORP.	37.75	Feb. 10, 1970
1970	S	100	SUNSTRAND CORP.	38.75	May 25, 1970
1970	S	200	DRESSER INDUSTRIES	68.50	May 28, 1970
1970	S	100	MEAD CORP.	38.56	May 25, 1970
1971	S	100	PEEL ELDER LTD.	24.75	April 20, 1971
1971	S	100	NATIONAL GENERAL CORP.	27.75	Jan. 20, 1971
1971	S	100	UNION OIL CO. OF CALIF.	43.56	Jan. 20, 1971
1971	S	100	CROWN CORK & SEAL	25.00	Jan. 20, 1971

RAF TRADING, INC., a New York Corporation, also a Member of the INDEPENDENT INVESTOR PROTECTIVE LEAGUE, CONDUCTED THE FOLLOWING TRADES OF SECURITIES:

YEAR	BOUGHT OR SOLD	NUMBER OF SHARES	NAME OF SECURITY	COMMISSION PAID	DATE OF TRANSACTION
1969	S	600	BATA RESOURCES LTD.	100.44	Feb. 27, 1969
1969	S	400	BATA RESOURCES LTD.	71.92	Feb. 27, 1969
1969	B	300	SCIENTIFIC RES. CORP.	91.50	Oct. 28, 1969
1969	S	100	SCIENTIFIC RES. CORP.	23.25	March 28, 1969
1969	S	200	SCIENTIFIC RES. CORP.	46.50	March 28, 1969
1969	B	200	ALPHA PORTLAND CEMENT	63.76	March 1, 1969

The commissions charged the parties to this action have been on a "fixed rate" basis. It has not been possible for any Members of the INDEPENDENT INVESTOR PROTECTIVE LEAGUE or myself to obtain any discount from the published rates of commission for trades on the New York Stock Exchange or American Stock Exchange. At least one broker has told me that he would be pleased to give me a discount from the fixed rates of commission but is not permitted to do so by the Rules of the respective stock exchanges and, if he did, he would be suspended from trading on the said stock exchanges.

It is true that the INDEPENDENT INVESTOR PROTECTIVE LEAGUE and I have not applied for Membership of the New York Stock Exchange or American Stock Exchange. Application for such Membership would have been futile since Membership on the Exchange is restricted to those persons presently holding "seats" thereupon.

On April 6, 1970 the defendant Stock Exchanges placed an "interim service charge" in effect which made "small trades" of less than 1000 shares of stock more expensive than trades in excess of 1000 shares. As set forth in the trading table in this affidavit, I, and other members of the Independent Investor Protective League have been charged the aforesaid "interim service charge".

On March 24th, 1972 the "volume discount" for trades in excess of 1000 shares was repealed and the "interim service charge" for "small trades" was repealed (none of which was given to either myself or members of the Independent Investor Protective League). This was replaced with a "negotiated commission schedule" on orders in excess of $300,000 together with a discount for volume transaction and a "surcharge" for small trades. I, and members of the Independent Investor Protective League, since March 24th, 1972, have not been given the benefit of "negotiated rates" (since our trades were too small to

qualify for the negotiated rate minimum, and, because our trades were less than 100 shares, a higher rate of commission was charged to us.

Since March 24th, 1972 I, as a tenant in common with my brother, Mr. Frank Gordon, have conducted the following trades:

a. Sold 100 shares of Pell Elder Common Stock.

b. Sold 200 shares of General Aniline and Film Corp. preferred.

c. Sold 200 shares of Alpha Portland Cement Common Stock.

d. Sold 200 shares of Houdielle Industries Preferred Stock.

Since March 24th, 1972 BETTY SANDS, a member of the Independent Investor Protective League had the following stock transactions.

STOCK	NUMBER OF SHARES	COMMISSION PAID	BOUGHT OR SOLD	DATE OF TRANSACTION
BORG-WARNER COMMON	200	$96.78	Sold	April 28, 1972
SOUTHDOWN	300	$96.70	Bought	March 29, 1972
SOUTHDOWN	300	$99.06	Sold	May 25, 1972
BARRY-WRIGHT	300	$74.76	Bought	July 31, 1972
FEDERAL CO.	200	$77.20	Sold	Sept. 13, 1972
REXHAM	200	$38.80	Sold	Sept. 13, 1972

During the hearings held by the Securities and Exchange Commission (which resulted in the "Order" of September 24, 1971 wherein the Securities and Exchange Commission did not object to certain commission practices, of the defendant Stock Exchanges) the undersigned appeared before the Commission to express his opposition to the aforesaid rates. After the order was issued the matter was appealed to the United States Court of Appeals for the Second Circuit (Docket 71-1924).

The Securities and Exchange Commission successfully dismissed this appeal on the ground that no "order" had been, in fact, issued and that the Commission had merely set forth its informal views. Thereupon the undersigned brought proceedings in the United States District Court for the District of Columbia. The Securities and Exchange Commission again successfully dismissed this suit (Docket 1984-71). The Commissions position, as set forth in the briefs submitted to both Courts, is significant in this case.

In the Court of Appeals proceeding the Commission stated that:

> * * * The Commission's letter of comment to the Exchange did not order the Exchange, petitioners, or any other person to do or to refrain from doing anything. Nor did the letter "approve" or "disapprove" the Exchange's proposals. * * *

In the District Court proceeding the Commission stated that:

> * * * However, the question of the type and extent of immunity that may flow from Commission determinations regarding exchange rules and practices need not be decided in this case. *The appropriate forum for resolution of that question is in an antitrust action against a self-regulatory organization challenging its rules or the administration of such rules.* Indeed, plaintiffs recognize that they may seek to challenge exchange

> rules directly; they have instituted suit against the New York Stock Exchange for this very purpose. * * *"

The fact is that I, and the members of my organization, are being seriously damaged by the practices complained of in this suit. The defendant stock exchanges, and the brokerage firm members, have engaged in a combination and conspiracy to fix commission rates, to limit membership in the exchanges, to grant large investors discriminatory prices over small investors, and to carry out many practices in violation of the anti-trust laws of the United States.

I submit to the Court that, as a matter of fact, it is more expensive to carry out a trade of more than 1000 shares of stock or one in excess of $300,000, than a small trade of 100 shares. This is so because a large trade has a market direct effect while a small trade has very little effect, in and of itself, on the market. Therefore, in the case of a small trade, it is merely necessary to make a bid or accept one. In the case of a large trade, however, the sale must either be negotiated at a great deal of time and expense, or the stock must be "fed out" in a succession of small trades, to avoid disrupting the market.

I therefore submit that, in this case, there are triable issues of fact that require a trial and, as a matter of law, the Complaint states a cause of action.

In the event that the Court requires further allegations to be made in the pleadings, of which the undersigned is presently not aware, the undersigned respectfully requests leave to amend the complaint in an appropriate manner.

Wherefore the undersigned prays that the defendants' motions be in all respects denied.

s/Richard A. Gordon
Richard A. Gordon

Sworn to
February 20th, 1973

LETTER OF PLAINTIFFS' ATTORNEY TO HON. MORRIS E. LASKER

BADER AND BADER

April 27th, 1973

Re: Gordon v. New York Stock Exchange Civil Action 71 Civil 1496 MEL

Hon. Morris E. Lasker
United States District Judge
United States District Court
Southern District of New York
Federal Building
Foley Square
New York, N.Y.

Dear Judge Lasker,

In connection with the above matter I enclose a new article which appeared in the *Wall Street Journal* this morning.

As you note from this article the United States Department of Justice is taking the same position as the plaintiffs in this suit with respect to the question of fixed commission rates.

According to the article in question the Department of Justice has intervened in *Thill Securities* (cited by the plaintiff in its memorandum) and will submit a brief seeking the elimination of fixed commission rates.

It also seems to be plain that the present suit more directly impinges on the issue of fixed commission rates than the Thill suit and, in view of the letter written to the Attorney General, it may be that the attorney general may move to intervene in the present suit.

It is further interesting to note that *Thill* is pending in the Seventh Circuit which is the same circuit that decided *Kaplan vs. Lehamn Brothers* which is the sole authority

relied upon by the defendants in support of their motion for summary judgment.

lWB/cf
cc: All defendants attorneys

WALL STREET JOURNAL ARTICLE
DATED FRIDAY APRIL 27, 1973

NEW CHICAGO OPTIONS EXCHANGE SUED BY U.S. OVER MINIMUM FEES; BIG BOARD RULING DUE

WASHINGTON—The Justice Department expanded its antitrust attack on fixed minimum brokerage rates by suing to bar their use on the newly formed Chicago Board Options Exchange.

And next week, the department is expected to further intensify this attack by asking a federal district court, in a case pending in Milwaukee, to order an end to fixed stock brokerage fees on the New York Stock Exchange.

The civil antitrust suit filed yesterday came on the first day of operations for the options exchange, a Chicago Board of Trade affiliate that provides the nation's first organized market devoted to the trading of a special type of securities called puts and calls.

The complaint filed in U.S. district court in Chicago asks the court to bar the options exchange from fixing the level of commission rates and brokerage fees charged by brokers trading securities options. A securities option is a contract for the right to purchase or sell shares for a set period of time at a price determined at the time the contract is entered. A contract for the right to sell is commonly referred to as a put and a contract for the right to purchase as a call.

Injunction Sought

The Justice Department said the options exchange is violating the Sherman Antitrust Act by establishing rules that "jointly fix and maintain" minimum brokerage commissions, floor brokerage rates and other fees to be charged by members for the purchase and sale of securities options.

Such rules deprive the public of the right to trade securities options on the Chicago exchange at competitively determined commission rates, the department charged. It also alleged that price competition has been eliminated in the sale of services among member brokers of the options exchange.

The lawsuit asks that the exchange and its members be permanently enjoined from fixing commission rates or other fees for brokerage services or from engaging in any other practices having a similar purpose or effect. The options exchange is the only securities option market registered with the Securities and Exchange Commission, which previously approved the fixed brokerage rate system and other rules of the exchange.

Rates Defended

A spokesman for the options exchange said: "We haven't seen the Justice Department complaint. As it has been described to us, we gather that the complaint is part of the department's effort to abolish fixed commission rates at all levels on all exchanges. We understand that there is nothing in the complaint that would prevent the continued operation of our exchange."

The options exchange "has fixed rates only below the level of $30,000, as compared with a $300,000 level prevailing on most exchanges," the spokesman said. "We believe it is appropriate, reasonable and entirely lawful, and that we will prevail in the lawsuit," he added.

The suit against the options exchange is the latest episode of the continuing controversy over application of antitrust laws to industries regulated by agencies such as the SEC. The basic question is whether some practices, such as rate-fixing, are exempt from antitrust challenge because they're overseen by regulatory agencies.

Much of the controversy has centered on the New York Exchange, which traditionally has fixed rates for its

brokerage firm members that have been followed by the rest of the securities industry. Until now, the Justice Department has used indirect pressure to force the Big Board away from its fixed rate system to one under which rates are negotiated between broker and customer. The department has, for example, participated in numerous SEC proceedings where it has suggested that the fixed rates may violate antitrust laws. It has also issued numerous strongly worded statements about the subject in speeches and in congressional testimony.

First Such Action

On Tuesday, the department is expected to take its strongest step to date to force the Big Board to abandon the fixed rate structure, some of which is gradually being phased out under an SEC-approved plan that will take several years. The move will come in a pending private antiturust suit against the exchange in a federal district court in Milwaukee.

The suit in Milwaukee was originally brought by Lewis D. Thill, a Milwaukee securities broker. It challenges a Big Board rule that limits sharing of commissions from transactions in Big Board-listed securities between members and nonmembers of the exchange. While the Justice Department didn't file the suit, it subsequently intervened in the case and, in effect, now is one of the plaintiffs.

On Tuesday, the department is expected to file a legal brief in the case that, among other things, will ask the court to issue an order requiring the elimination of fixed brokerage rates without delay. It wasn't immediately clear whether the brief would seek a specific date for ending fixed rates. In any event, it will mark the first time the department has sought court action against the Big Board's rate structure.

The department has challenged other fixed rate plans in court. In December 1971, it filed an antitrust suit

challenging fixed rates on the Chicago Board of Trade, where commodities futures are traded. That suit still is pending, Justice Department officials said, but most of the rate dispute has been resolved in private antitrust actions against the Board of Trade.

NOTICE OF APPEAL

NOTICE OF APPEAL TO U.S. COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES DISTRICT COURT SOUTHERN DISTRICT OF NEW YORK

RICHARD A. GORDON, Individually and as President of INDEPENDENT INVESTORS PROTECTIVE LEAGUE, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced.

Plaintiffs.

-against-

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC. and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the NEW YORK EXCHANGE and AMERICAN STOCK EXCHANGE.

Defendants.

PLEASE TAKE NOTICE that RICHARD A. GORDON and INDEPENDENT INVESTORS PROTECTIVE LEAGUE, the plaintiffs herein, individually and as Representative Plaintiffs, hereby appeal to the United States Court of Appeals for the Second Circuit, from a Final Order made by Hon. MORRIS E. LASKER, one of

the Judges of the United States District Court for the Southern District of New York, said Order being made on December 3rd, 1973 and entered in the Office of the Clerk of the United States District Court for the Southern District of New York on December 9th, 1973, said Order granting Summary Judgment to the Defendants herein dismissing the Complaint, and, for that reason, refusing to consider the plaintiffs' motion for a Class Action determination, and this appeal is taken from said Order and from each and every part thereof.

Dated: December 6th, 1973

Yours, etc.
s/
BADER & BADER
Attorneys for Plaintiffs
274 Madison Avenue
New York, N.Y. 10016

OPINION OF UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AFFIRMING OPINION OF DISTRICT COURT

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1045—September Term, 1973.

(Argued June 5, 1974 Decided June 28, 1974.)

Docket No. 74-1043

RICHARD A. GORDON, individually and as President of Independent Investors Protective League, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Plaintiff-Appellant,

v.

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC. and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Defendants-Appellees.

Before:

KAUFMAN, *Chief Judge*,
MANSFIELD and MULLIGAN, *Circuit Judges*.

Appeal from an order entered in the United States District Court for the Southern District of New York, Morris E. Lasker, *Judge*, granting summary judgment and dismissing complaint principally alleging that the fixing of stock exchange commission rates violates the antitrust laws.

Affirmed.

I. WALTON BADER, New York, New York (Bader and Bader, New York, New York, on the brief), *for Appellant*.

WILLIAM E. JACKSON, New York, New York (Milbank, Tweed, Hadley & McCloy, Lord, Day & Lord, Brown, Wood, Fuller, Caldwell & Ivey, New York, New York, on the brief; Isaac Shapiro, Mark L. Davidson, John J. Loflin, James B. May, New York, New York, of counsel), *for Appellees*.

SEYMOUR H. DUSSMAN, Attorney, Department of Justice, Washington, D.C. (Thomas E. Kauper, Assistant Attorney General, on the brief), as *Amicus Curiae urging reversal*.

LAWRENCE E. NERHEIM, General Counsel, Securities Exchange Commission, Washington, D.C. (Walter P. North, Associate General Counsel, Frederic T. Spindel, Special Counsel, Theodore L. Freedman, Attorney, on the brief), as *Amicus Curiae urging affirmance*.

KAUFMAN, *Chief Judge:*

Whether the minimum rate structure presently employed by the nation's stock exchanges enjoys immunity from attack under the antitrust laws is a question of such importance that we need not belabor its significance. The Supreme Court in *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963), although subjecting the application of an exchange rule to antitrust scrutiny, acknowledged that if there were Securities Exchange Commission [SEC] jurisdiction to review a challenged rule, a different case would arise con-

cerning antitrust exemption. We are here presented with that different case.

The complaint itself provides all the facts necessary for our disposition. Richard A. Gordon brought this private antitrust action on April 2, 1971, on his own behalf and for a purported class of small investors, against the New York Stock Exchange, Inc. [NYSE], the American Stock Exchange, Inc. [Amex], and two representative member firms of the exchanges,[1] alleging that the exchanges' fixed minimum commission system violated the Sherman Act, 15 U.S.C. §§ 1 and 2 (1970), and the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970). More specifically, we read Gordon's complaint to have alleged: (1) that the exchange rules providing for a volume discount from the minimum commission rate in the case of large transactions, together with negotiated rates only on portions of orders in excess of $500,000,[2] and the interim surcharge on transactions involving less than 1000 shares,[3] amounted to a system of price discrimination in violation of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970),[4] and the Sherman Act, 15 U.S.C. §§ 1, 2 (1970); and (2) that the fixed commissions charged those unable to avail themselves of negotiated rates constituted a scheme of price-fixing, contrary to the provisions of the Sherman Act, 15 U.S.C. §§ 1, 2 (1970).[5]

1 Merrill, Lynch, Pierce, Fenner & Smith, and Bache & Co., Inc.

2 NYSE Const. Art. XV, § 2 (1971); *subsequently amended;* Amex. Const., Art. VI, § 2 (1971), *subsequently amended.*

3 NYSE Rule 383 (1971), *repealed* April 1, 1974; Amex Rule 396 (1971), *amended* April 1, 1972.

4 Gordon also claimed that the volume discounts were "unreasonably low prices for the purpose of destroying competition or eliminating a competitor," in violation of 15 U.S.C. § 13a (1970). Although the district court made no finding in this regard, plaintiff does not press the point on appeal.

5 The complaint also challenged rules which limited exchange membership, and which denied discounted commission rates to nonmember brokers who used exchange facilities. The district court concluded that these claims were frivolous. We agree, since § 3(a)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(3) (1970), clearly contemplates limitations on both exchange membership and nonmember access to exchange facilities.

Without reaching the merits of Gordon's principal claims, the district court found the challenged practice of fixing commission rates not within the jurisdiction of an antitrust court since judicial oversight of this particular aspect of exchange self-regulation had been displaced by the review power vested in the SEC under § 19(b) of the Securities Exchange Act of 1934 [1934 Act], 15 U.S.C. § 78s(b) (1970). Accordingly, the district court granted the defendants' motion for summary judgment, and dismissed the complaint.[6] For the reasons set forth below, we agree.

Since Gordon's other claims are essentially frivolous,[7] we turn directly to his principal allegation that the exchange practice of fixing commission rates violated the Sherman Act. Any analysis of the interrelation of the antitrust laws and the system of supervised exchange self-regulation embodied in the 1934 Act must begin with *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963). The Court was there asked to decide whether the NYSE's

6 Because the district court considered affidavits and exhibits annexed as well as the pleadings, it properly concluded that the motion to dismiss should be treated as one for summary judgment. Rule 12(b), F.R. Civ. P.

7 We agree with the district court that there is no precedent for the assertion that brokerage services are "commodities" within the meaning of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970).

Gordon raises on appeal for the first time the claim that the combination of surcharges, volume discounts, and negotiated rates violates 15 U.S.C. § 13(c) (1970), as an allowance or commission not granted for services rendered. Although we decline to entertain the claim because it was not raised in the district court, we note that § 13(c) proscribes such practices only "in connection with the sale or purchase of goods, wares, or merchandise . . . ."

enforcement of an exchange rule without notice or hearing, resulting in the removal of a nonmember's private telegraph wires from member offices—concededly a group boycott—was subject to antitrust scrutiny. Seeking to achieve the requisite accommodation between the antitrust laws and the 1934 Act's policy of exchange self-regulation, Mr. Justice Goldberg, speaking for a majority of the Court, formulated the following test:

> Repeal [of the antitrust laws] is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary.

373 U.S. at 357.

In *Silver*, the Court concluded that exercise of its antitrust jurisdiction was proper for two reasons. Because there was no possibility of SEC review of the challenged act—disconnection of Silver's wires to member offices—assertion of judicial oversight would have resulted in no conflict, between agency and court, rendering cumbersome and inconsistent the system of administrative regulation. 373 U.S. at 358. Moreover, denial of antitrust jurisdiction on the facts presented in *Silver* would have left no governmental body to perform the antitrust function of preventing an injury to competition which could not be justified as furthering legitimate self-regulatory ends. *Id.* at 358-61. Though the Court hinted that some breathing space should be left the exchange for unsupervised self-regulation, if found inexcusable the failure to provide the procedural safeguards of notice and hearing. *Id.* at 361-67.

The instant case, of course, is *toto caelo* different from *Silver*, for there is here governmental oversight of the fixing of commission rates, vested expressly in the SEC pursuant to § 19(b)(9) of the 1934 Act, 15 U.S.C. § 78s(b)(9)

(1970). And, as we have indicated, the *Silver* Court recognized that a "different case" would be posed if the exchange practice allegedly violative of the antitrust laws were subject to control by the SEC. Although the *Silver* rationale might well authorize us to ground our holding here on the existence of SEC review power, we do not rely upon that authority alone to support a finding of antitrust immunity. Rather, we are of the view that both the language and the history of the 1934 Act, together with the sound policy behind supervised exchange self-regulation, mandate the conclusion that Congress intended to exempt from the antitrust laws the exchange practice of fixing commission rates.

Section 19(b) of the 1934 Act states, in pertinent part:

> The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as . . . (9) the fixing of reasonable rates of commission, interest, listing, and other charges . . .

It is clear from this language that the "congressional aim in supervised self-regulation is to insure fair dealing and to protect investors from harmful or unfair trade

practices," *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 130 (1973). It is equally plain that Congress considered the "fixing of reasonable rates of commission" to be essential to meeting these goals, for it listed this factor explicitly among the twelve items so denominated. Finally, and most importantly for this jurisdictional dispute between an antitrust court and the SEC, Congress vested in the Commission the power to determine whether changes are "necessary" in the exchanges' rate-fixing practices to assure fulfillment of the goals of the Act. Accordingly, Congress defined in § 19(b) those matters fundamental to achieving "the aims of the Securities Exchange Act," *Silver* v. *New York Stock Exchange*, 373 U.S. at 361, and accorded the SEC the authority to make whatever changes respecting those matters are "necessary or appropriate" (§ 19(b)) to effectuate those aims —*i.e.*, in the terms of the *Silver* test, "necessary to make the Securities Exchange Act work." 373 U.S. at 357.

If the discussion in *Silver* of a core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws, is to be given any meaningful application, we are of the view that it must have reference to the practices enumerated in § 19(b), and in this instance to the fixing of reasonable rates of commission. The Supreme Court also recognized in *Silver* that the exercise of antitrust jurisdiction, where it conflicted with a power of review expressly delegated to the SEC, could render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the 1934 Act. 373 U.S. at 358-61. Frustration of those aims would be the inevitable consequence of duplicative or inconsistent standards announced contemporaneously by courts and Commission.

That Congress intended Commission-supervised exchange self-regulation to be of central importance in the

scheme of the 1934 Act is emphasized by the legislative history of the Act. Both House and Senate reports stress the broad responsibility left with the exchanges to administer their own affairs. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 13 (1934). The grant of this unique self-regulatory power, however, was conditioned upon the creation of the SEC, invested with broad discretionary powers equal to the complex and changing nature of the problems arising in the securities industry. *Cf.* H.R. Rep. No. 1383 at 6-7. Rather than charge the Commission with oversight of specific instances of abuse, Congress authorized it to condition an exchange's right to register upon its enactment of rules "just and adequate to insure fair dealing and to protect investors." 15 U.S.C. § 78f(d) (1970). And as to several specific matters inextricably linked with "fair dealing" and "protection of investors" from harmful or unfair trade practices, the Commission was empowered by § 19(b) to order exchanges to make such amendments in their rules as the Commission found necessary to carry out the purposes of the Act.

Yet the legislative history of the Act does not simply indicate the central significance of supervised self-regulation in effectuating the purposes of the Act. Concerning the practices here challenged, we find most persuasive Congress's manifest recognition of the Commission's competence to serve the necessary antitrust objective of preserving competition, by delegating to it control over practices which, but for § 19(b) of the 1934 Act, would be per se violations of the antitrust laws. Those familiar with the development of antitrust law know that seven years before the Securities Exchange Act was passed, the Supreme Court decided that price-fixing was a per se violation of the Sherman Act. *United States* v. *Trenton Potteries Co.*, 273 U.S.

392 (1927). Despite this clear holding, the 1934 Act explicitly provides for "the *fixing* of reasonable rates of commission, interest, listing, and other charges" [emphasis added]. 15 U.S.C. § 78s(b)(9) (1970). Reference to the Senate hearings dispels any doubt on this score, for they make plain the congressional awareness that this provision "would permit the Commission to fix rates." *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st and 2d Sess., pt. 16, at 7705 (1934) (statement of Samuel Untermyer). Moreover, the practice in the securities field of industry-wide agreement on minimum fees—dating back to 1792, *see* SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 295 (1963)—was repeatedly acknowledged both in committee hearings, *see Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 13, at 6075, 6080-81 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess., at 423-34 (1934), and in the debates on the Act, *see, e.g.*, 78 Cong. Rec. 8087, 8091-92, 8490, 8493-94 (1934).

We draw two conclusions from this delegation of power over exchange commission rates. By permitting so potentially harmful a practice as rate-fixing, Congress recognized that the exchange commission system bore crucially upon achievement of the goals of the 1934 Act. Further, by placing in the hands of the SEC the regulation of rate-fixing—a practice the effects of which the Supreme Court acknowledged its inability to assess, *see United States* v. *Trenton Potteries, supra*, 273 U.S. at 398—Congress made clear its judgment of the Commission's competence to assume the central role in assuring investor protection and exchange fair dealing.

Exemption from the antitrust laws with regard to the fixing of minimum rates of commission is not only mandated by both the language and the legislative history of the 1934 Act, and in particular § 19(b)(9), but is grounded as well in sound policy considerations governing regulation of the securities industry. Of principal concern is the danger, clearly contemplated by *Silver*, 373 U.S. at 358, that courts and the SEC would subject exchanges to repetitive or conflicting standards. There is little question but that the commission rate structure is the keystone of the economic viability of the brokerage industry, and a matter of vital importance to individual investors as well. Steering effectively between the often competing interests of "seller" and "buyer"—reducing the barriers to investor trading, while at the same time assuring a return sufficient to preserve brokerage capacity—becomes far too hazardous with two hands on the tiller.

Nor are the hazards of repetition and conflict in this case a matter of mere speculation, as a review of the wide-reaching and systematic character of recent SEC action regarding rate regulation makes evident. In 1963, following the congressional mandate embodied in 15 U.S.C. § 78s(d), the SEC published its extensive Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963), dealing among other matters with the practice of fixing stock exchange commission rates. Recent Commission action with regard to the particular practices challenged by Gordon began in 1959, with a request to the NYSE to study the possible introduction of a volume discount. *See* SEC Securities Exchange Act Release No. 5889 (Feb. 20, 1959). Comment was requested on both NYSE and SEC proposals on January 26, 1968. SEC Securities Exchange Act Release No. 8239 (Jan. 26, 1968). On May 28, 1968, the NYSE was asked either to implement a suggested commission schedule incorporating volume discounts for

round lot portions over 400 shares, or to eliminate minimum commissions on portions of orders in excess of $50,000, before September 15 of the same year. Public hearings also were commenced on May 28, 1968, to determine "changes in the present commission rate structure . . . required to benefit the investing public." SEC Securities Exchange Act Release No. 8324 (May 28, 1968). The same release requested that other exchanges make "appropriate" changes similar to those demanded of the NYSE. The Commission thereafter notified the NYSE that the requirements of Release No. 8324 would be satisfied by provision for a volume discount on orders in excess of 1000 shares, Letter of Manuel F. Cohen to Robert W. Haack (August 30, 1968), and on September 4, 1968, it extended the mandated effective date to December 5, 1968. SEC Securities Exchange Act Release No. 8399 (Sept. 4, 1968).

Commission approval was given on August 2, 1970, for the interim surcharge challenged by Gordon, in order "to provide emergency financial relief while more fundamental alterations of the existing rate structure can be considered." Approval was subject to the understanding that the surcharge would expire after 90 days, and that the NYSE would restore full brokerage services for small investors and remove transaction size and other limitations on such accounts. Letter of Hamer H. Budge to Robert W. Haack, April 2, 1970. Approval was given on similar conditions to the Amex proposed rule 396, requesting a like interim surcharge. Letter of Irving M. Pollack to Ralph S. Saul, April 10, 1970. The terms of the surcharges were thereafter extended, SEC Securities Exchange Act Release 8923 (July 2, 1970), and expired in March (NYSE) and April (Amex) of 1972.

The recent SEC program which aims at gradual introduction of negotiated rates strongly enforces our view

that it would be unwise for a court to interfere under the antitrust laws. Although SEC Securities Exchange Act Release No. 8324 (May 28, 1968) contemplated the introduction of negotiated rates as an alternative to volume discounts, the Commission determined by October 22, 1970, that fixed charges on portions of orders in excess of $100,000 were—even when joined with volume discounts—neither necessary nor appropriate to achieving the purposes of the 1934 Act. Letter of Hamer H. Budge to Robert W. Haack, October 22, 1970; SEC Securities Exchange Act Release No. 9007 (Oct. 22, 1970). The Commission subsequently indicated that a $500,000 "breakpoint" would be acceptable, Letter of Richard B. Smith to Robert W. Haack, February 10, 1971; SEC Securities Exchange Act Release No. 9105 (March 11, 1971), and sent to the other exchanges copies of its correspondence with the NYSE regarding negotiated rates for their "appropriate consideration." Letter of Irving M. Pollack to the presidents of the American, Boston, Cincinnati, Detroit, Midwest, National, Pacific Coast, Philadelphia-Baltimore-Washington, Salt Lake, and Spokane Stock Exchanges, March 17, 1971. In its Statement on the Future Structure of the Securities Markets (Feb. 2, 1972), issued subsequent to the initiation of Gordon's lawsuit, the Commission announced its conclusion, grounded on the results of monitoring undertaken concurrently by the SEC and the exchanges, that a reduction in the breakpoint to $300,000 was appropriate, and commanded its implementation by April of 1972. Not long thereafter, SEC Securities Exchange Act Release No. 10383 (Sept. 11, 1973) decreed the end of all fixed commission rates by April 30, 1975. As a further step in the process of gradual abandonment, SEC Securities Exchange Act Release No. 10560 (Dec. 14, 1973) requested the immediate introduction of limited

price competition in transactions falling below the current breakpoint.

The Commission's program of measured introduction of negotiated rates has been carefully gauged to avoid undesirable side-effects on both the industry and the investing public. The Statement on the Future Structure of the Securities Markets, 15, cautions:

> We must bear in mind . . . that we are dealing with an industry which has operated under fixed commission rates for a very long time. It is necessary to measure the effect of competitively determined commissions very carefully on a step by step basis.

We are told, for example, that among the consequences certain to result from the introduction of negotiated rates across the boards is the failure of a number of inefficient brokerage firms. Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public,* 22 Stan. L. Rev. 675, 699 (1970). The SEC study revealed that the exchanges have operated for a long time under cartelized commission rates, which exceed those which would have been charged by firms of efficient scale. Thus, firms too small and inefficient to survive in a competitive market have so far been sheltered. Introduction of negotiated rates across the entire range of trades would, it is thought, cause many of these firms to go under. Baxter, *supra,* 22 Stan. L. Rev. at 699. Much of the damage resulting from such attrition would be borne by the investing public, to whom failing member firms would be indebted in the form of credit balances. Measured withdrawal could avoid the loss of those investor funds by allowing failing brokers to "exit by orderly merger or liquidation rather than by bankruptcy." Note, *Fixed Brokerage Commissions: An Antitrust Anal-*

ysis After the Introduction of Competitive Rates on Trades Exceeding $500,000, 85 Harv. L. Rev. 794, 811 (1972).

We have recounted at such length the Commission's actions on brokerage rate changes not solely to demonstrate the extraordinarily active surveillance by the Commission, in accordance with Congress's expressed declaration, nor even to establish that the invocation of antitrust jurisdiction would result in repetition of and conflict with SEC action. Of greater importance, it seems to us, is the reminder it offers that when something as crucial to the survival of the securities industry as its very ancient rate structure is at stake, diagnoses and changes must come from an agency with the Commission's expertise. The wisdom of the SEC's actions is, of course, not before us. We stress only that it is clear that, with respect to the fixing of commission rates, the process of administrative review in the first instance is far superior to judicial review.[8]

That Congress recognized agency superiority in this regard should not, moreover, come as a great surprise, for the courts themselves, by the time of the 1934 Act's passage, had admitted as much in abandoning the rule of reason approach to price-fixing. Indeed, the adoption of a standard of per se illegality in *Trenton Potteries* was thought necessary by the Supreme Court to relieve the

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8 By this we do not intend to imply that withdrawal of antitrust jurisdiction is based on the SEC's "primary" jurisdiction over the practices challenged by Gordon. *Cf. Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264, 276-77 (7th Cir. 1970) (Swygert, J., concurring). As our earlier discussion of the language and history of the 1934 Act indicates, we are of the view that Congress intended to exempt commission rate-fixing from the operation of the antitrust laws, and consequently deprived the courts of even "secondary" jurisdiction to entertain Sherman Act claims like that which Gordon asserts. Judicial review of SEC action would, however, be proper, either under the Administrative Procedure Act, 5 U.S.C. §§ 702, 704 (1970), or pursuant to the provisions of the 1934 Act, 15 U.S.C. § 78y (1970).

judiciary of the need to determine the reasonableness of prices set by horizontal agreement. The Court there stated:

> In the absence of express legislation requiring it, we should hesitate to adopt a construction [of the Sherman Act] making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies.

United States v. *Trenton Potteries*, 273 U.S. 392, 398 (1927). Such questions as the effect of fixed commission rates on trading volume and broker solvency, or the effect of competition on and the necessity for exchange membership, are not of the sort which courts can answer as well as the SEC. The statutory scheme exhibits congressional confidence that the Commission will be more capable of resolving problems of this nature.

We are not unmindful of the Seventh Circuit's decision in *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970), heavily relied upon by Gordon and the Department of Justice as amicus curiae for appellant.[9] The claim there presented against the NYSE's anti-rebate rule is of a different character from Gordon's challenge to rate-fixing practices. For, as the *Thill* court stated, there was "no evidence as to the extent to which the challenged rule is subject to actual review by the SEC . . ." 433 F.2d at 270. Moreover, the anti-rebate practice, not specified in any of the twelve subsections of § 19(b), may not be within that core of antitrust immunity to which we have referred. But it is a fact that at the time *Thill* was decided, the SEC was conducting hearings into,

9 The SEC has also filed a brief as amicus curiae for the appellees.

among other matters, the "economic access to exchange markets by nonmembers broker-dealers . . ." SEC Securities Exchange Act Release No. 8324 (May 28, 1968). And it would be difficult to maintain that the effect of the anti-rebate rule on investor protection, fair dealing in securities, or fair administration of an exchange is in any significant respect different from the practice of commission rate-fixing.[10] *See* Note, *Antitrust Laws and the Securities Exchanges*, 66 Nw. U.L. Rev. 100, 106 n. 40 (1971). Thus, to the extent our decision today is inconsistent with *Thill*, we find ourselves constrained to disagree with the holding there announced.[11]

We emphasize that the conclusion we reach today by no means implies that Gordon at no time may have access to the courts. After Commission action, judicial review of its decision is proper pursuant to the provisions of the Ad-

10 As such, it would appropriately fall within the rule which we today announce, under the language of § 19(b)(13), 15 U.S.C. § 78s(b)(13) (1970) ("similar matters").

11 Judge Campbell in *Thill* relied heavily upon *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963) for the proposition that implied exemption from the antitrust laws was *a fortiori* improper on the facts before the court. 433 F.2d at 272. In *Philadelphia National Bank* the Court held that, despite the congressionally required approval of the Comptroller of the Currency, pursuant to the Bank Merger Act of 1960, 12 U.S.C. § 1828 (1970), a merger between the Philadelphia National Bank and Girard banks remained subject to antitrust action by the Department of Justice.

Although we are not unmindful of the disfavor with which antitrust exemption is generally regarded, *see, e.g., California* v. *Federal Power Commission*, 369 U.S. 482 (1962), we perceive significant differences between *Philadelphia National Bank* and the case which we today decide. We note that the history of the Bank Merger Act evidenced a congressional intent not to immunize bank mergers from at least Sherman Act attack, *see* 374 U.S. at 352, whereas the 1934 Act entrusts the SEC with supervision of rate-fixing, a practice which outside the confines of the 1934 Act is a per se violation of the Sherman Act. *Cf. Silver* v. *New York Stock Exchange*, 373 U.S. at 347-49 (recognising that a group boycott carried out within the framework of the 1934 Act is not a per se antitrust violation).

FILED
FEB 24 1975
MICHAEL RODAK, JR., CLERK

APPENDIX

IN THE

Supreme Court of the United States

October Term, 1975

No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

—v.—

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR CERTIORARI FILED SEPTEMBER 19, 1974
CERTIORARI GRANTED NOVEMBER 18, 1974

ERRATA SHEET

Substantive Errors

Exhibit 7 (A-253) – Is duplicated following Exhibit 8 (A-280)

A-294–A-298 – Charts should be part of Exhibit 12 not Exhibit 13

Typographical Errors

Page No.	*Mistake*	*Correction*
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	motio	motion
	Merrill,	Merrill (no comma)
A-88	overflor	overflow
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REMAINDER OF OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ministrative Procedure Act, 5 U.S.C. §§702, 704 (1970), *see* Independent Broker-Dealers' Trade Association v. SEC, 442 F.2d 132 (D.C.Cir.), cert. denied, 304 U.S. 828, 92 S.Ct. 63, 30 L.Ed.2d 57 (1970), and, in the case of Commission orders, under the provisions of the 1934 Act, 15 U.S.C. §78y (1970). On such review, a court is competent to consider, in accordance with standards appropriate for review of agency action, *see* Administrative Procedure Act §10(e), 5 U.S.C. §706 (1970), the weight given by the Commission to competitive factors in achieving the goals of the 1934 Act.

For the reasons stated, we affirm the district court's grant of summary judgment and dismissal of Gordon's claim.

Affirmed.

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

Richard A. GORDON, Individually and as President of Independent Investors Protective League, an unincorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced, Plaintiff,

v.

NEW YORK STOCK EXCHANGE, INC., et al., Defendants.

No. 71 Civ. 1496.

United States District Court, S.D. New York.

Dec. 3, 1973.

Proceedings on motion for summary judgment in antitrust action brought against stock exchanges and individual members. The District Court, Lasker, J., held that party who had not sought membership in stock exchange could not bring action based on claim members were arbitrarily limited, that stock trade executions were not "commodities" within Robinson-Patman Act, and that commission rate structure of exchanges was within congressional policy of exchange self-regulation.

Motion granted.

1. Monopolies 28(1.6)

Person who had never applied for membership in stock exchanges could not be heard to complain that memberships were arbitrarily limited. Clayton Act, §4, 15 U.S.C.A. §15.

2. Monopolies 12(18)

In view of language of Securities Exchange Act of 1934 to effect that nonmembers' access to exchange facilities is limited, party could not base action against stock exchanges on claim that they denied use of their facilities to nonmembers unless nonmembers paid same rate of commission charged general public. Clayton Act, §4, 15 U.S.C.A. §15; Securities Exchange Act of 1934, §3(a)(3), 15 U.S.C.A. §78c(a)(3).

3. Trade Regulation 911

Stock trade executions are not "commodities" within meaning of Robinson-Patman Act. Clayton Act, § 2(a) as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. §13(a).

See publication Words and Phrases for other judicial constructions and definitions.

4. Monopolies 12(18)

Federal court lacked jurisdiction to entertain antitrust attack on commission rate structure of stock exchanges, since fixing of commission falls squarely within congressional policy of exchange self-regulation. Clayton Act, §4, 15 U.S.C.A. §15; Securities Exchange Act of 1934, §19(b), 15 U.S.C.A. §78s(b).

Bader & Bader, New York City, for plaintiff.

Milbank, Tweed, Hadley & McCloy, New York City, for defendants New York Stock Exchange, Inc. and Bache & Co., Inc.

Lord, Day & Lord, New York City, for defendant American Stock Exchange, Inc.

Brown, Wood, Fuller, Caldwell & Ivey, New York City, for defendant Merrill Lynch, Pierce, Fenner & Smith, Inc.

MEMORANDUM

LASKER, District Judge.

In this action, brought by Richard A. Gordon, individually and as President of Independent Investors Protective League, against the New York Stock Exchange, the American Stock Exchange ("the Exchanges") and their member firms, plaintiff alleges several violations of the Robinson-Patman Act and the Sherman Act, to the detriment of "small investors" (those ineligible for either "volume discounts" on trades of over 1,000 shares, or negotiated rates on trades above the $500,000 [now $300,000] "break-point").

Specifically, plaintiff attacks the Exchanges' practices of making their facilities available only to members and of limiting the number of memberships; he also alleges that members have conspired with the Exchanges to fix rates for small investors at an unreasonably high level in view of the actual cost of executing a trade; that negotiated rates and volume discounts are set at unreasonably low levels in view of the actual costs of execution; and that this scheme unlawfully discriminates against small investors. In short, plaintiff makes a number of related claims, the essence of which is a broadside attack on the present commission structure of the Exchanges.

Defendants have moved for an order dismissing the action and granting summary judgment on the grounds that the practices complained of are within the exclusive jurisdiction of the Securities and Exchange Commission, that the SEC, acting pursuant to §19(b) of the Exchange Act of 1934, 15 U.S.C. §78s(b), has been actively regulating these practices, and that, consequently, the practices are exempt from the provisions of the antitrust law so that the court is without subject matter jurisdiction.

I.

We deal first with plaintiff's related claims regarding the Exchanges' practices of limiting the number of memberships, and denying the use of their facilities to non-members unless they pay the same rate of commission charged the general public (Complaint, Paragraph 17).

[1] As to the first claim, plaintiff lacks standing to sue since he has not met the threshold requirement of §4 of the Clayton Act: "Any person who shall be injured in his business or property by reason of any thing forbidden in the antitrust laws may sue therefor . . ." (15 U.S.C. §15). Since it is undisputed that plaintiff has never made application for membership in either defendant Exchange, he cannot be heard to complain that memberships are arbitrarily limited. See Billy Baxter, Inc. v. Coca-Cola Company, 431 F.2d 183, 187 (2d Cir. 1970), cert. denied, 401 U.S. 923, 91 S.Ct. 877, 27 L.Ed.2d 826 (1971); Data Digests, Inc. v. Standard & Poor's Corporation, 43 F.R.D. 386, 387-388 (S.D.N.Y. 1967).

[2] Plaintiff's second claim must also fail in view of the clear language of the Exchange Act of 1934 to the effect that non-members' access to Exchange facilities is limited. Section 3(a)(3) states:

> "The term 'member' when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to *make us of the facilities of an exchange for transactions thereon without payment of a fee or with the payment of a commission or fee which is less than that charged the general public,* and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm." (emphasis added)

The fact that the limited membership characteristic of the Exchanges inheres in their very nature has been recognized by the Supreme Court, Silver v. New York Stock Exchange, 373 U.S. 341, 350-351, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1963) and this Circuit, Robert W. Stark, Jr., Inc. v. New York Stock Exchange, Inc., 346 F.Supp. 217, 228 (S.D.N.Y. 1972), aff'd per curiam, 466 F.2d 743 (2d Cir. 1972) CCH Sec. L. Rep. ¶93,607.

II.

[3] Plaintiff's claims of price discrimination predicated upon the Robinson-Patman Act, 15 U.S.C. §13(a), are without merit. The Act requires that the alleged price discrimination be in connection with "commodities of like grade and quality". The authorities are clear that services and intangibles (such as stock trade executions) are not "commodities" within the meaning of the Act. Columbia Broadcasting System v. Amana Refrigeration, 295 F.2d 375 (7th Cir. 1961); Baum v. Investors Diversified Services, Inc., 409 F.2d 872, 875 (7th Cir. 1969), and cases cited therein.

III.

Plaintiff's remaining claims relating to the commission rate structure of the Exchanges pose the question whether the Exchanges, subject to SEC supervision, can fix commission rates without incurring Sherman Act liability. It is, of course, conceded by defendants that any such immunity must be provided, if at all, by the Securities & Exchange Act of 1934.

The question of the extent to which the 1934 Act exempts the Exchanges from the anti-trust laws has not been considered in this Circuit since Silver v. New York Stock Exchange, 373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1963). That case involved a non-member broker who had

secured private wire connections with certain New York Stock Exchange firms. The Exchange had approved Silver's connections on a temporary basis, but subsequently ordered them disconnected without notice or hearing. After observing that the Exchange's actions absent justification from the Exchange Act, would have constituted a *per se* violation of the Sherman Act, the *Silver* court sought to reconcile the "antitrust aim of eliminating restraints on competition with the effective operation of a public policy contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." (*Silver*, 373 U.S. at 349, 83 S.Ct. at 1252.)

Noting that the Exchange Act does not give the commission jurisdiction to review *particular instances of enforcement* of Exchange rules, the Court stated that consequently the question of antitrust exemption did "not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power," and that court review of the circumstances there presented "is therefore not at all incompatible with the fulfillment of the aims of the [Act]". (*Silver* at 359, 83 S.Ct. at 1258.) The court concluded that the severance of the private wires occurred under "totally unjustifiable circumstances" (*Silver* at 361, 83 S.Ct. 1246) and that no policy of the Exchange Act was served by denial of notice and opportunity for hearing.

In so holding, however, *Silver* did not specify the circumstances in which a federal district court must decline jurisdiction to avoid a possible conflict with the commission, and specifically reserved decision on the possible anti-trust immunity of exchanges where "review of exchange self-regulation [is] provided through a vehicle other than the antitrust laws. . . ." (p. 360, 83 S.Ct. p. 1258).

[4] We hold that this court lacks jurisdiction to entertain an anti-trust attack on the commission structure of the

Exchanges, since the fixing of commissions falls squarely within the congressional policy of exchange self-regulation embodied in the 1934 Act. Since the Act expressly directs the SEC to supervise the "fixing of reasonable rates of commission" (§19(b)(9)), we believe this is the "different case," on which *Silver* reserved decision, where review of exchange self-regulation is available "through a vehicle other than the antitrust laws" (*Silver*, p. 360, 83 S.Ct. p. 1258).

In so holding, we are in disagreement with the Seventh Circuit. See Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264 (7th Cir. 1970), cert. denied, 401 U.S. 994, 91 S.Ct. 1232, 28 L.Ed.2d 532 (1971), a decision to which we return later on.

We believe that while *Silver* quite properly punctured the umbrella of anti-trust immunity claimed by the Exchange, it did not intend Congress' unique self-regulatory scheme to be totally dampened by the continuous interference of an anti-trust court. We read *Silver* as holding that certain limited areas of Exchange regulation—such as potentially anti-competitive and arbitrary conduct directed at non-members—are properly interfered with by a reviewing court since the Act purports to regulate only the conduct of registered exchanges (and their members) with regard to the public, rather than the entire securities business. But *Silver* also contemplates a certain zone of anti-trust immunity in the regulatory process where there is little threat of such arbitrary and discriminatory activity.

Without venturing to describe the full contours of this immunity, we believe that the Exchange Act, as constructed by *Silver*, left the power to fix commission rates within the exclusive jurisdiction of the Exchange, subject to commission supervision.

This construction finds ample support in the language of *Silver*. The court describes the Exchanges as "by their nature bodies with a limited number of members" (373

U.S. p. 350, 83 S.Ct. p. 1253) with a "federally mandated duty of self-policing" (p. 352, 83 S.Ct. p. 1254).

> "The pattern of governmental entry . . . was by no means one of total displacement of the exchanges' traditional process of self-regulation . . . Thus the Senate Committee Report stressed that the 'initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so." S.Rep. No. 792 [73d Cong., 2d Session (1934)] at 13.

The court continues (at 360-361, 83 S. Ct. at 1258-1259) that:

> "The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act. Without the oversight of the Commission to elaborate from time to time on the propriety of various acts of self-regulation, the Exchange is left without guidance and without warning as to what regulative action would be viewed as excessive by an antitrust court. . . . But, under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act."

The clear import of this language is that the Exchange Act sanctions certain "anti-competitive" features of the Exchanges so long as they further the policy of self-regulation and are subject to Commission supervision,

guided by the "rule of reason". Indeed, we note that *Silver* sets out at some length (pp. 354-356, 83 S.Ct. 1246, n. 9) the welter of Exchange rules restricting members' relations with non-members, which were there in issue.

In holding that the *manner of enforcing* these rules was illegal, *Silver* never intimates that the rules themselves are subject to anti-trust attack, and indeed recognizes the necessity for them (pp. 354-356, 83 S.Ct. 1246).

The facial language of the Exchange Act gives the Exchange and the Commission the power to "fix" commission rates. Section 6(d) of the Act requires that registered exchange adopt rules "just and adequate to insure fair dealing and to protect investors;" that is, §6(d) mandates self-regulation. As *Silver* observes "[t]he general dimensions of the duty of self-regulation are suggested by §19(b) of the Act, 15 U.S.C. §78s(b), which gives the Commission power to order changes in exchange rules respecting a number of subjects . . ." (pp. 352, 1254). §19(b) recites:

> "Sec. 19. * * * The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as * * * (9) *the fixing of reasonable rates of commission, interest, listing, and other charges;* (10) *minimum units of trading . . .*; * * * and (13) similar matters." (emphasis added)

We recognize that the legislative history of the 1934 Act is, perhaps typically, ambiguous as to Congress' intent regarding the Exchanges' long-standing practice of fixing commission rates. As Professor Baxter of Stanford Law School has noted:

> "[t]he attention of Congress in 1934 was focused on problems of dishonesty, manipulation, and solvency, and . . . no coherent congressional purpose was articulated concerning the problems of intra-industry competitive structure." Baxter, New York Stock Exchange Fixed Commission Rates: A Private Cartel Goes Public, 22 Stan.L.Rev. 675, 685 (1970).

However, Congress clearly was aware of the Exchanges' rate-fixing practices, since both House and Senate debates on the Act specifically refer to the fixing of commissions. See, e.g., 78 Cong. Rec. 8087, 8092, 8490, 8493-94 (1934).[1]

Nevertheless, however unclear the Congressional debate in 1934 may be as to the permissibility of fixing commissions, we believe the history of Exchange rate-regulation since the passage of the Act is entitled to substantial weight. As to the proper construction of the Act, we cannot overlook the fact that Exchange regulation of fixed commissions has existed virtually unchallenged for nearly 40 years since the passage of the Act.

In the case most in point, Kaplan v. Lehman Brothers, 250 F.Supp. 562 (N.D.Ill.1966), aff'd 371 F.2d 409 (7th Cir. 1967), shareholders of five mutual funds brought a treble damage action against the New York Stock Exchange and several stock brokerage firms claiming that the

1. In Thill Securities Corp. v. New York Stock Exchange, 57 F.R.D. 133 (E.D.Wis. 1973), the post-trial brief of the United States, as intervenor, arguing the *illegality* of fixed commission, and the anti-rebate rule concedes that it cannot be said that Congress intended to outlaw fixed minimum commissions in passing the 1934 Act. (Post-trial brief at pp. 8-9).

fixing of minimum commissions was a *per se* violation of the Sherman Act. The Court of Appeals affirmed an award of summary judgment for the defendants since, as the trial court noted, plaintiff's *per se* allegation was defective in light of the weighing process required under *Silver*. Though *Kaplan* is distinguishable on its facts, the court there recognized the possibility of a conflict of jurisdiction with the Commission. Its comments are applicable here since the gist of the complaint in both cases is that plaintiff paid higher rates than would have obtained in the absence of Exchange rate-fixing.

"The plaintiffs have complained of the rates because they are fixed. If they had complained instead that the rates were too high, they would find no support in the antitrust laws. The remedy for a level of rates which is unreasonably high rests with the SEC. Ratemaking is a matter for which the courts are ill-equipped and accordingly a matter traditionally committed to an administrative agency. [citation omitted]. The SEC since its establishment has exercised this power of review over Exchange rates of commission, and it has inaugurated a regular system of reporting from Exchange members to furnish the necessary information.

> . . . To leave the determination of reasonableness to the prospective decisions of the agency which is especially qualified and responsible for the general supervision of the industry will assure the intention of Congress as well as the interests of the public." (250 F.Supp. at 566).

We note that, beginning with the 1963 Special Study of The Securities Markets, the SEC and the Exchanges have undertaken intensive examination of Exchange commission structures and related matters. In 1968, the SEC initiated public hearings on the commission rate structure.

Certain rate adjustments, such as the volume discount, and the interim charge, and experiments with negotiated

commissions have resulted from these activities. Most significant, the SEC recently announced, in its Release 10383 (September 11, 1973), its intention to terminate the Exchange practice of fixing minimum commissions on all securities transactions after April 30, 1975, unless the Exchange in the meantime alters its rules to the same effect. It is fair to infer that the SEC is continuing to exercise its jurisdiction actively over rate-setting, pursuant to §19(b)(9) of the Act.

Moreover, recent developments in Congress regarding the commission structure support the holding here. The Senate recently rejected amendments to the 1934 Act which would have mandated the elimination of fixed commissions within two years. See 119 Cong. Record, S11385-6, June 18, 1973. It is reasonable to infer from the proposal of these amendments that Congress did not believe fixed commissions were already illegal under the anti-trust laws, and, of course, the rejection of the amendments suggests that Congress does not now regard fixed rates as offensive to the Exchange Act or the anti-trust laws.

Finally, we come to the recent decision in Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264 (7th Cir. 1970), cert. denied, 401 U.S. 994, 91 S.Ct. 1232, 28 L.Ed.2d 532 (1971).

In *Thill*, a non-member broker-dealer attacked the anti-rebate rule of the New York Stock Exchange as violative of the Sherman Act. The Seventh Circuit reversed the grant of summary judgment in favor of the New York Stock Exchange predicated on a claim of immunity, and remanded the case to the trial court for further evidence on the effects of the anti-competitive acts complained of, the extent to which the rule was subject to actual review by the SEC, and the extent to which the anti-rebate rule was "necessary to make the Securities Exchange Act work." (*Thill*, 433 F.2d at 270).

We believe that *Thill* is distinguishable from our case. First, the Act contains no specific directive to the SEC to

supervise member-non-member relations; second, there was before the court no record of active SEC supervision in the area; third, the court thought the power to refuse to share commissions with non-members was a "weapon 'that can be used to injure a particular competitor' " (p. 270) and the plaintiff had alleged that the anti-rebate rule had in fact been unevenly applied.

Indeed, in distinguishing *Kaplan, supra*—another Seventh Circuit case—the *Thill* court placed considerable weight on the distinction it perceived between the non-discriminatory application of fixed commission rates (at issue in *Kaplan*) uniformly charged to the *public*, and the application of rules governing rebates with non-member broker-dealers (433 F.2d p. 270).

We must add, if it is not already clear, that if *Thill* is to be read as holding that an anti-trust court has concurrent jurisdiction with the SEC over *all* potentially anti-competitive practices and rules, we disagree.

For the foregoing reasons, defendants' motion for summary judgment is granted.

In view of our decision here, we do not consider plaintiff's motion for a class action determination.

It is so ordered.

ONE OF THE CHARTS INCLUDED WITH EXHIBIT 13: COMMISSION AS A PERCENT OF VALUE FOR VARIOUS PRICED STOCKS AT SELECTED ORDER SIZES UNDER PRESENT AND PROPOSED COMMISSION RATES

COMMISSION AS A PERCENT OF VALUE FOR VARIOUS PRICED STOCKS AT SELECTED ORDER SIZES UNDER PRESENT AND PROPOSED COMMISSION RATES

Trade Size	Commission As Percent of Value Under Present Commission Rates					Commission As Percent Of Value Under Proposed Commission Rates				
Shares	Price Per Share					Price Per Share				
100-400	1.70	1.35	1.13	0.75	0.49	1.60	1.30	1.10	0.80	0.68
Value										
$ 30,000	1.70	1.35	1.13	0.75	0.49	0.93	0.82	0.78	0.75	0.88
60,000	1.70	1.35	1.13	0.75	0.49	0.73	0.73	0.69	0.64	0.63
120,000	1.70	1.35	1.13	0.75	0.49	0.72	0.68	0.62	0.59	0.57
360,000	1.70	1.35	1.13	0.75	0.49	0.705	0.65	0.58	0.55	0.54
720,000	1.70	1.35	1.13	0.75	0.49	0.70	0.64	0.575	0.54	0.53
2,160,000	1.70	1.35	1.13	0.75	0.49	0.70	0.635	0.57	0.54	0.52
10,800,000	1.70	1.35	1.13	0.75	0.49	0.70	0.63	0.57	0.53	0.52

MISSING PART OF EXHIBIT 14

(3) *The Exchange considers that continuation of customer-directed give-ups weakens the economic basis of the minimum commission structure itself. Therefore, the Board has voted in favor of their step-by-step prohibition.* For obvious reasons, customer-directed give-ups cannot be effectively abolished by the unilateral action of one national securities exchange. To be effective, the action must apply uniformly to all markets. If not, such give-ups would likely continue on any exchange whose rules permitted them, to the detriment of exchanges where they were not allowed.

At a time when the principle of minimum commissions is being questioned, it may be more difficult to defend the economic basis of the minimum commission law if members are able to give up, or give away, a substantial part of the minimum commission. In any case, a commission schedule that includes a volume discount would reduce the wherewithal for give-ups.

We are asking the SEC to take appropriate action to initiate step-by-step prohibition of all customer-directed give-ups. Step-by-step implementation, over a period of at least one year, would give firms an opportunity to adjust to the economic impact of such a change. We would, of course, expect continuation of bona fide agency-principal relationships between members for such services as clearing, floor brokerage and introducing of accounts on a disclosed basis.

The Costs and Revenues Committee is still continuing its work with respect to such matters as intra-industry rates and policy regarding institutional membership, and expects to report on these subjects at a later date.

If approved by vote of the membership, the new commission schedule and related amendments and rules would be the first revision of New York Stock Exchange rates in nine years.

Basic shifts are taking place in the nature of the securities business. It is imperative that our commission structure be responsive to the facts of life in today's marketplace.

In the letter of January 2 to the membership, it was noted that a major factor in the Board's endorsement of important structural changes at that time was that a network of practices in the industry are eroding the present minimum commission structure.

An intricate maze of give-ups, give-aways, reciprocal practices, manufactured participations in trades, transported trades moved from one exchange to another, and the like, have resulted in considerable leakage of the commission dollar.

Regulatory developments since January have underscored the need for taking action along the lines then recommended.

Shortly after we presented our January proposal, the SEC advanced an incompatible suggestion, its proposed Rule 10(b)-10, requiring that any give-up directed by an investment company must, in effect, be rebated to the institution. In a comment on that proposal, the Department of Justice questioned the necessity for and propriety of any minimum commissions. Then the SEC in advancting its proposed "interim" commission proposal in May, and requesting that the NYSE place it in effect by September 15, 1968, offered as an alternative, the abolition of minimum commissions on all orders above $50,000. The SEC's "interim" proposal quite apart from its serious effect on member firm revenues, would present severe operational problems.

ADDITIONAL MATERIAL TO BE ADDED TO CHART WHICH FORMS A PART OF EXHIBIT 17 APPEARING AT P. A-324

NYSE business), average commissions per transaction for all except two came closer to the lower figure than the higher. The average commission was $42.60 and the range was from $37.63 to $50.51.

COMMISSION PER SECURITY AGENCY TRANSACTION 16 LARGE RETAIL FIRMS FIRST HALF 1969

Firm	Average Commission*	Firm	Average Commission*
1	$37.63	9	$42.76
2	38.18	10	43.14
3	38.30	11	43.84
4	39.49	12	45.21
5	40.22	13	45.43
6	40.49	14	45.48
7	40.69	15	49.19
8	41.12	16	50.51

*Mean of averages for the first and second quarters.

Source: Wright Associates, Management Consultants, New York, N.Y.

ADDITIONAL MATERIAL TO BE ADDED TO CHART WHICH FORMS A PART OF EXHIBIT 17 APPEARING AT P. A-316

Among the 156 firms that experienced losses on SCI income in 1969, fully one-quarter had losses equivalent to over 25% of capital and over one-third had losses in the 11% to 25% range.

Among the 228 firms with SCI profits, about one in four had after-tax profits in excess of 15%, while about one in three had after-tax profits of 5% or less.

Taking all 392 firms together, the proportion with after-tax returns in excess of 15% was only one out of six. At the other end of the scale, the proportion of all firms with losses on their capital in excess of 15% was one out of five. One out of ten firms experienced losses of more than 25% on their invested capital. Obviously, such monumental losses cannot be sustained by any industry for very long.

LOSS OR AFTER-TAX RETURN ON CAPITAL FIRST-HALF 1969 AT ANNUAL RATES

Profit or Loss Rate	Number of Firms		Proportion of Total Firms	
(Per cent)			(Per cent)	
Losses				
51% & over	14		4%	
-26—50	25		7	
-16—25	32		8	
-6—15	44		11	
-1—5	41		10	
Total, loss firms		156		40%
Broke even		8		2%
Profits				
1—5	83		21	
6—15	83		21	
16—25	34		8	
26—50	14		4	
51% & over	14	228	4	58%
Total, all firms		392		100%

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-304

RICHARD A. GORDON, etc.,
Petitioner,

against

NEW YORK STOCK EXCHANGE, INC., et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

STATEMENT OF RESPONDENTS IN SUPPORT OF THE ISSUANCE OF A WRIT OF CERTIORARI

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October 23, 1974

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IN THE

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OCTOBER TERM, 1974

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

STATEMENT OF RESPONDENTS IN SUPPORT OF THE ISSUANCE OF A WRIT OF CERTIORARI

QUESTION PRESENTED

The question presented is whether, in light of this Court's decision in *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963) (*"Silver"*), review should be granted to resolve the conflict between the decision of the Seventh Circuit in *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971) (*"Thill"*)* and the decision below of the Second

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* The *Thill* rationale was applied to registered national securities associations in *Harwell* v. *Growth Programs, Inc.*, 451 F.2d 240 (5th Cir.), *opinion on reh.*, 459 F.2d 461, *cert. denied, sub nom., Nat'l Ass'n of Securities Dealers* v. *Harwell*, 409 U.S. 876 (1972).

Circuit holding that the rules of the New York and American Stock Exchanges fixing minimum rates of commission to be charged by their members on exchange transactions are exempt from the Sherman Antitrust Act (15 U.S.C. § 1 *et seq.*) since such rules are authorized by Section 19(b)(9) of the Securities Exchange Act of 1934 (the "Exchange Act"; 15 U.S.C. § 78a *et seq.*) and are subject to review and revision by the Securities and Exchange Commission (the "SEC").*

COUNTER-STATEMENT OF THE CASE

A. Nature of the Case, Course of Proceedings and Disposition

This action was commenced on April 2, 1971, by Richard A. Gordon, individually and on behalf of an alleged class of "small investors", against the New York Stock Exchange, Inc. (the "NYSE"), the American Stock Exchange, Inc. (the "Amex") (collectively the "defendant exchanges") and Merrill Lynch, Pierce, Fenner & Smith, Inc. and Bache & Co., Inc., as representatives of an alleged class consisting of the defendant exchanges' members. The complaint (App. 1-10),** while somewhat ambiguously drafted, challenged as an illegal price fixing conspiracy the long established and publicly known practice of the defendant exchanges of adopting and enforcing rules fixing minimum rates of commission for transactions in securities listed on the exchanges. Also attacked were the provisions of the constitutions of the two exchanges fixing the number of their respective members and the alleged

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* The District Court decision affirmed by the Court below is reported at 366 F.Supp. 1261 (S.D.N.Y. 1973). The decision of the Court below is reported at 498 F.2d 1303 (2d Cir. 1974). All references to the decisions below will be by citation to the relevant page of the appendix attached to the petition.

** References to (App. ....) are to the appendix filed in the Court of Appeals. References to (A. ....) are to the appendix attached to the petition.

resulting exclusion of plaintiff from use of the exchanges' trading facilities. Violations of the Robinson-Patman Act (15 U.S.C. § 13(a) *et seq.*) were also pleaded.

The District Court, holding in abeyance petitioner's motion for a class action determination, granted respondents' motion for summary judgment and dismissed the complaint on the grounds that the exchanges' commission rules were exempt from antitrust attack. (App. 355, see 357, 340; A. 26, 27) On appeal petitioner was joined by the Antitrust Division of the Department of Justice as *amicus curiae* in urging the Court of Appeals to reverse the District Court's judgment and remand for trial (A. 36). The SEC, on the other hand, filed a brief *amicus curiae* arguing for affirmance on the grounds asserted by respondents (A. 36).

The Court of Appeals (per Kaufman, C.J.) unanimously affirmed the District Court's ruling on the twin grounds that this Court's opinion in *Silver* compelled an implied repeal of the antitrust laws and that the legislative history of the Exchange Act manifested a Congressional intent to exempt exchanges from the antitrust laws in respect of self-regulatory action undertaken by them within the scope and purposes of the Act and subject to SEC review (A. 39-43).

B. The Relevant Facts

Most of the "Facts" in petitioner's Statement of the Case are irrelevant and exceed the permissible limits set by Rule 23(1) of this Court. There is no real issue as to whether petitioner has been excluded from membership in exchanges to which, as the District Court found, he had never made application (A. 23) or as to his other purported claims under Section 2 of the Sherman Act (15 U.S.C. § 2) and Section 2(a) or (c) of the Robinson-Patman Act (15 U.S.C. § 13(a) *et seq.*) which, as the Court of Appeals found, are "essentially frivolous" (A. 38). The only pertinent question is whether registered national securities exchanges may adopt and enforce rules fixing minimum commission rates free from antitrust liability.

The material facts, which are indisputable, may be briefly stated as follows:

Since their founding, the NYSE and the Amex have at all times had rules (a) limiting the number of individuals who may be members and (b) prescribing the minimum commissions to be charged by members to non-members on exchange transactions (App. 39; 179). The Exchange Act, enacted in 1934, required that all national securities exchanges register with the SEC and become subject to its regulation. The NYSE and Amex applied to the SEC for registration pursuant to Section 6 of the Exchange Act and submitted copies of their respective constitutions and rules, including the rules limiting their respective memberships and prescribing the minimum commission rates then in effect (App. 39-40; 179-80; 195-200). The SEC approved the applications and found the exchanges' constitutions and rules, including those concerning membership limitations and minimum commissions, "just and adequate to insure fair dealing and to protect investors" (App. 39-40; 179-80).

Since 1934 the NYSE and the Amex have amended their commission rules a number of times in conjunction with the SEC. The most recent amendments, challenged here by petitioner, were those which became effective on or about December 5, 1968, April 5, 1970, April 5, 1971, March 24, 1972, April 24, 1972, September 25, 1973, February 24, 1974 and April 1, 1974 (App. 180). In each instance, the amendments were filed with the SEC at the time of adoption as required by Section 6(a)(4) of the Exchange Act. In addition, pursuant to SEC Rule 17a-8, 17 C.F.R. § 240.17a-8, the defendant exchanges filed each proposed amendment with the SEC not less than three weeks prior to the taking of any action on such amendment. (App. 40; 180).

While petitioner urges (pet. pp. 4-6, see 11-13) that the SEC has taken no action with respect to commission rates and has not performed its regulatory functions, the

undisputed facts are quite to the contrary. Thus, the District Court observed that, beginning at least as early as 1963, "the SEC and the Exchanges have undertaken intensive examination of Exchange commission structures and related matters." (A. 32) Likewise, the Court of Appeals, taking judicial notice of the SEC's regulatory activities since 1963 regarding the commission rate structure, concluded that the agency's record demonstrated "extraordinarily active surveillance". (A. 48).

On the basis of the statutory scheme, the legislative history and the SEC's record of active regulation the Court below concluded, under *Silver* and the doctrine of implied repeal, that the rules challenged were exempt from antitrust attack.

REASONS FOR GRANTING CERTIORARI

Petitioner advances (pet. pp. 2-3) four grounds which he asserts warrant a writ of certiorari: (1) the question presented is of great public importance; (2) there is a clear conflict among the Courts of Appeals regarding the proper application of the principles of *pro tanto* antitrust repeal set forth in this Court's *Silver* opinion; (3) grave, but unspecified, Constitutional questions are raised; and (4) the decision below, is, for reasons not stated, in conflict with *Silver*.

Petitioner's vague claim of Constitutional question, raised now for the first time, is completely lacking in merit.* Likewise, his assertion that the decision below conflicts with *Silver* is erroneous. The Court of Appeals for the Second Circuit properly interpreted and applied *Silver* in affirming the dismissal of the complaint.

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* Since no such Constitutional question was raised or argued below, it is not properly before this Court. See, *Simpson* v. *Union Oil Co.*, 411 F.2d 897 (9th Cir.), *rev'd on other grounds*, 396 U.S. 13 (1969); see also, *Neely* v. *Eby Construction Co.*, 386 U.S. 317, 330 (1967); *Lawn* v. *United States*, 355 U.S. 339, 362, n. 16 (1958).

Nonetheless, respondents support the issuance of a writ of certiorari because the question presented by this case is of great public importance and because various decisions in other Circuits, in conflict with the holding below and this Court's *Silver* opinion, subject them to differing, irreconcilable standards of conduct and disrupt the regulatory scheme established by the Exchange Act.

Accordingly, respondents submit this Statement to put the issues fully before this Court so that it may affirm the decision below and thereby resolve the present disarray among the Circuits' views on this antitrust question which is crucial to the operation of national securities exchanges.

ARGUMENT

I

The Scope of an Exchange's Antitrust Exemption for Self-Regulation Subject to SEC Review is a Question of Public Importance as to Which There is a Split in the Circuits

The large values involved in this case, the differing views as to the parameters of this Court's opinion in *Silver* and the conflicting decisions by lower courts cloak with urgency the issue of the extent of exchanges' antitrust exemption.

When this Court was confronted, in *Silver,* for the first and only time, with the need to consider the scope of the antitrust exemption afforded exchange self-regulatory conduct by reason of the Exchange Act, it recognized the importance of the question:

> "We deal here today with the question, of great importance to the public and the financial community, of whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the Securities Exchange Act of 1934." 373 U.S. at 342.

The conduct in question in *Silver*—the withdrawal of private wire connections without a hearing—was neither explicitly contemplated by the Exchange Act nor subject to SEC oversight jurisdiction. As a consequence this Court found no antitrust exemption, but indicated that where challenged self-regulatory conduct was within the scope and purposes of the Act and subject to SEC review a "different case" as to exemption would be presented (373 U.S. at 360).

The issue reserved in *Silver* and presented by this case arose for the first time in *Kaplan* v. *Lehman Bros,* 250 F.Supp. 562 (N.D. Ill. 1966), *aff'd,* 371 F.2d 409 (7th Cir.), *cert. denied,* 389 U.S. 954 (1967), where shareholders in five investment companies (*i.e.,* mutual funds) sued derivatively and on behalf of a class of all other shareholders charging—as petitioner did in this case—that exchange fixing of minimum commission rates was a violation of Section 1 of the Sherman Act (15 U.S.C. § 1). The District Court held the commission rules exempt from the antitrust laws because they are subject to review and revision by the SEC pursuant to Section 19(b)(9) of the Exchange Act. Relying on *Silver,* the Court concluded:

> "This is the 'different case', since the SEC exercises a general and continuing power to change, alter, or supplement the rules of the Exchange fixing the rates of commission. Since review is afforded within the system of securities regulation, there is no need to resort to the antitrust laws for a remedy." 250 F.Supp. at 566.

The Court of Appeals for the Seventh Circuit unanimously affirmed (371 F.2d 409). This Court denied certiorari.

Had the issue been settled by *Kaplan,* despite the failure by this Court to place its imprimatur on the Seventh Circuit's ruling, there would be no split in the Circuits and no pressing reason would exist for this Court to grant certiorari now. But *Kaplan* did not lay the matter to rest.

Three years later, in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971), the Seventh Circuit was once again called upon to deal with a potential conflict between the antitrust laws and the Exchange Act. Thill Securities Corp. claimed that the NYSE had violated the antitrust laws by prohibiting its members from sharing commissions with non-members (including non-member brokers) or granting to such non-members any rebate or discount from the fixed minimum (the so-called "antirebate rule"). The District Court, relying on *Silver* and *Kaplan,* found the antirebate rule to be an integral part of the NYSE's Congressionally-authorized fixed commission practice, fully subject to SEC review which was being exercised through pending hearings, and therefore granted summary judgment for the NYSE. CCH 1969 Trade Cas. ¶ 72,911 (E.D. Wis., Aug. 26, 1969).

The Court of Appeals for the Seventh Circuit—by a 2 to 1 decision, generating three separate opinions—reversed. That Court read *Kaplan* as merely holding that exchange rules adopted pursuant to the self-regulatory powers granted by the Exchange Act and subject to review and revision by the SEC were not *per se* violations of the antitrust laws (433 F.2d at 268-69). Statutory authorization for commission fixing was not enough, in the Court's view, nor was SEC oversight jurisdiction, even if exercised, sufficient to grant an antitrust exemption. The Court held that an exemption from the antitrust laws for challenged self-regulatory conduct may be found only after a registered national securities exchange and its members demonstrate that the SEC has been actively "exercising its proper supervisory power" over such conduct (433 F.2d 271), and prove to the satisfaction of an antitrust court that the SEC's policy decisions regarding such conduct are both justified and necessary to the achievement of purposes or objectives of the Exchange Act (433 F.2d 273).

In short, under *Thill,* there can be no antitrust exemption—traditionally a pure question of law—without a full

trial on the merits with proof that the conduct permitted by the SEC is justified.

Respondents submit that the reasoning of the *Thill* decision—as gleaned from the three separate opinions rendered—is, in light of *Silver,* insupportable. The *Thill* decision is at odds with both *Silver* and *Kaplan.* The Court below—as well as the District Court it affirmed—in holding the exchanges' commission rules exempt from antitrust attack, reluctantly came to the same conclusion and pointedly expressed disagreement with the *Thill* result and rationale (A. 34, 50). Endorsing the decision in *Kaplan,* the Court below found that the antitrust exemption suggested by *Silver* for exchange self-regulatory conduct required no evidentiary record, required no trial and, most important, did not require an exchange and its members to defend the SEC's exercise of its statutory authority.

In turn, the *Thill* result and rationale were most recently followed in the Seventh Circuit in *Fredrickson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 5 CCH Trade Reg. Rep. 1974-2 Trade Cas. ¶ 75,227 (N. D. Ill., Sept. 9, 1974)—yet another case challenging exchange fixed commissions as a violation of Section 1 of the Sherman Act. There, the District Court found, as did the Court below, that national securities exchanges have traditionally prescribed minimum rates of commission. Likewise, the District Court found—as the Second Circuit did—that Congress, in enacting Section 19(b)(9) of the Exchange Act, had intended to subject such rules to the oversight jurisdiction of the SEC. Finally, the *Fredrickson* Court, like the *Gordon* Court, found that the SEC has in fact exercised its supervisory power over exchange minimum commission rates. Nonetheless, the District Court in *Fredrickson,* expressly disagreeing with the *Gordon* decision, refused to find an exemption from the antitrust laws.

In announcing its conclusion, the *Fredrickson* Court expressed certain reservations about its holding and granted defendants' motion, under 28 U.S.C. § 1292(b), to certify the antitrust exemption issue for interlocutory re-

view. The Seventh Circuit has yet to rule on defendants' petition for leave to appeal.*

It is clear that the question presented by this case, argued to no less than three panels of appellate judges in two Circuits and resulting in the present split of authority, is not only ripe for review by this Court but can only be finally and properly resolved by a further ruling of this Court.

II

The Court Below Correctly Interpreted this Court's Decision in *Silver*

This Court recognized in *Silver* that the Exchange Act established a unique system of self-regulation which placed upon the nation's registered securities exchanges the initial duty to promulgate rules governing their own affairs and committed to the SEC as guardian of the public interest a power of oversight and revision of those rules. Likewise, this Court pointed out that although the Exchange Act contains no express exemption from the antitrust laws and its regulatory scheme is not sufficiently pervasive to create total exemption as to all exchange activities, nevertheless repeal of the antitrust laws is to be regarded as implied where a particular instance of exchange self-regulation falls within the scope and purposes of the Exchange Act and is subject to SEC power of review and revision (373 U.S. at 357, 360-61).

This Court also recognized that to subject self-regulatory activities of the Exchange to antitrust review in areas where the SEC has supervisory jurisdiction could involve problems of "conflict or coextensiveness of coverage with

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* The *Thill* rationale—at loggerheads with the reasoning of the Court below—was applied to an SEC-approved interpretation of a rule of a registered national securities association in *Harwell* v. *Growth Programs, Inc.*, 451 F.2d 240 (5th Cir.), *opinion on reh.*, 459 F.2d 461, *cert. denied, sub nom., Nat'l Ass'n of Securities Dealers* v. *Harwell*, 409 U.S. 876 (1972).

the [SEC's] regulatory power" (373 U.S. at 358). It was the absence of SEC power to review the specific action of the NYSE involved in the *Silver* case (withdrawal of certain non-member private wire connections) which led this Court to conclude that in the special circumstances there presented application of the antitrust laws was not incompatible with the provisions of the Exchange Act. At the same time the Court emphasized that:

> "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented." (373 U.S. at 360).

Dismissal of the complaint in this case by the District Court and affirmance by the Court of Appeals for the Second Circuit reflect the only permissible result under a proper application of both the Exchange Act and *Silver*.

Section 19(b)(9) of the Act provides:

> "The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as . . . (9) *the fixing of reasonable rates of commission, interest, listing, and other charges; . . .*" (Emphasis added).

Although Section 19(b)(9) is framed in terms of a grant of review power to the SEC rather than a direct grant of rule-making authority to exchanges, the provision authorizing

the SEC to "alter or supplement the rules of such exchange" with respect to "the fixing of reasonable rates of commission" obviously contemplates action by the SEC with respect to rates already set by an exchange. This is also apparent from the fact that under Section 19(b)(9) the SEC, as a prerequisite to any revision in existing rates, must first request the Exchange to "effect on *its own behalf*" any suggested "changes in *its* rules and practices." (Emphasis added).

The SEC, which is the agency charged with administration of the Exchange Act, fully supported this interpretation of Section 19(b)(9) in its brief *amicus curiae* urging the Court below to affirm the District Court's judgment.

Because the SEC is vested by Section 19(b)(9) with specific authority to review exchange rates for reasonableness and to exercise a general and continuing power to change, alter or supplement rules of the exchanges fixing rates of commission, the District Court properly held and the Court of Appeals correctly affirmed that this is the "different case" referred to by this Court in *Silver*, requiring a finding of antitrust exemption.

The Court below observed:

> "If the discussion in *Silver* of a core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws, is to be given any meaningful application, we are of the view that it must have reference to the practices enumerated in § 19(b) and in this instance to the fixing of reasonable rates of commission." (A.41)

CONCLUSION

For the foregoing reasons, and notwithstanding the fact that the decision below is in complete accord with this Court's decision in *Silver*, there can be no surcease of litigation on this question of great public importance until this

Court has finally spoken and resolved the conflict between the Second and Seventh Circuits. Therefore, a writ of certiorari should be issued to review the decision below.

Respectfully submitted,

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No. 74-304

In the Supreme Court of the United States

OCTOBER TERM, 1974

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

The Securities and Exchange Commission files this memorandum to urge that the Court grant the petition for a writ of certiorari to review the decision of the Court of Appeals for the Second Circuit rendered in this case on June 28, 1974.

STATEMENT

Petitioner, Richard A. Gordon, brought this private antitrust action on April 2, 1971 against respondents New York Stock Exchange, Inc., American Stock Exchange, Inc. and two member firms of these exchanges, charging that the exchanges' fixed minimum commission rate systems violated the Sherman Act, 15 U.S.C. §§ 1 and 2, and the Robinson-Patman Act, 15 U.S.C.

§ 13(a).[1] The suit, which petitioner instituted on his own behalf and for a purported class of "small investors," sought injunctive relief and treble damages of $1.5 billion. Petitioner specifically attacked exchange rules which (1) provided for a "volume discount" from the minimum commission rate for large transactions executed on the exchanges, (2) imposed an interim "surcharge" on the execution of "small transactions" of less than 1000 shares, and (3) authorized exchange members to negotiate the commission to be charged on that portion of a trnsaction in excess of $500,000 (now $300,000) while continuing to maintain a fixed minimum commission rate for smaller transactions. He also challenged rules of the exchanges imposing a limitation on exchange membership while prohibiting access of non-member brokers to exchange facilities at a discounted commission rate and forbidding members to share commission with non-members. These practices were alleged to constitute a system of price discrimination and a price-fixing conspiracy in contravention of the antitrust laws (Pet. App. 21-22, 37).

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[1]Respondents New York Stock Exchange, Inc. and American Stock Exchange, Inc. are national securites exchanges registered as such with the Commission pursuant to Section 6(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78f(d). Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Bache & Co., Inc. are member organizations of both exchanges and were sued individually as representatives of all member firms of these exchanges.

The district court, without considering the merits of petitioner's principal claims, granted summary judgment in respondent's favor and dismissed the complaint for lack of subject matter jurisdiction (Pet. App. 21). Characterizing the action as "a broadside attack on the present commission structure of the Exchanges" (Pet. App. 22), it held that an antitrust court was without jurisdiction to entertain an attack on the fixing of commission rates by the exchanges on the ground that the practices complained of are within the "exclusive jurisdiction" of the Commission, that the Commission, acting pursuant to Section 19(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78s(b), has been actively regulating these practices, and that consequently, the practices are exempt from the provisions of the antitrust laws (Pet. App. 22). In reaching this determination, the court found that the fixing of commissions fell "squarely within the congressional policy of exchange self-regulation" which is subject to Commission supervision under Section 19(b) of the Exchange Act[2] (Pet. App.

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[2]Section 19(b) of the Exchange Act provides in pertinent part:

> The Commission is . . . authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as . . . (9) the fixing of reasonable rates of commission, interest, listing, and other charges; . . . and (13) similar matters.

26). It concluded that where power to review particular exchange conduct has been vested in the Commission, effectuation of the policy of supervised self-regulation embodied in the Exchange Act requires displacement of judicial antitrust scrutiny in favor of the Commission's authority (Pet. App. 29). The district court therefore disagreed with the decision in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (C.A. 7), certiorari denied, 401 U.S. 994, insofar as *Thill* has been read as holding "that an antitrust court has concurrent jurisdiction with the SEC over *all* potentially anti-competitive practices and rules . . ." of a national securities exchange (Pet. App. 26, 34).

On petitioner's appeal, the Commission and the Antitrust Division of the Department of Justice participated *amici curiae:* the Commission supporting the trial court's judgment, the Department of Justice urging reversal. The court of appeals affirmed, stating that the requisite reconciliation between the antitrust laws and the scheme of supervised exchange self-regulation embodied in the Exchange Act must begin with an analysis of this Court's decision in *Silver* v. *New York Stock Exchange,* 373 U.S. 341. It reasoned that in *Silver* the enforcement of an exchange rule was held subject to antitrust scrutiny because of the absence of Commission authority to review the particular exchange conduct involved, and that this Court acknowledged in *Silver* that "if there were Commission jurisdiction to review a challenged [exchange] rule, a different case would arise concerning antitrust exemption" (Pet. App. 36-38). The court of appeals concluded that it was presented with that "different case" since under Section 19(b)(9) of the Exchange Act supervisory authority

over the fixing of commission rates is expressly vested in the Commission (Pet. App. 41). Stating that the exercise of antitrust jurisdiction in *Silver* was deemed proper because, in the absence of Commission review, assertion of judicial oversight would not result in conflict "between agency and court" (Pet. App. 39) and the denial of antitrust jurisdiction "would have left no governmental body to perform the antitrust function (*id.*), the court held that the existence of Commission review power in the instant case supported a finding of antitrust immunity for the challenged exchange practice of fixing commission rates (Pet. App. 40).

The court found additional support for its ruling concerning antitrust exemption. Referring to the test enunciated in *Silver* that repeal of the antitrust laws is to be implied only to the extent "necessary to make the Securities Exchange Act work," the court construed that test as necessarily contemplating a "core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws" (Pet. App. 41). From the language of Section 19(b) and the Exchange Act's legislative history, it determined that Congress defined in Section 19(b) those matters which it considered "fundamental to achieving 'the aims of the Securities Exchange Act' . . . and accorded the SEC authority to make whatever changes respecting those matters as are 'necessary or appropriate' . . . to effectuate those aims . . . ." (Pet. App. 41). It concluded that if this core of exchange self-regulation exempt from the antitrust laws is to have any meaning it must therefore "have reference to the practices enumerated in §19(b) and in this instance to the fixing of reasonable rates of commission" (Pet. App. 41). For, if the exchanges were subjected to "duplicative or inconsistent standards announced contemporaneously by

courts and Commission" the "inevitable consequence" would be to "render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the Exchange Act" (Pet. App. 41).

Finally, the court of appeals -- after observing that "it would be difficult to maintain" that the effect of the rule challenged in the *Thill* case is in any significant respect different from the practice of commission rate-fixing -- stated that "to the extent our decision today is inconsistent with *Thill,* we find ourselves constrained to disagree with the holding there announced" (Pet. App. 49-50).

DISCUSSION

This case presents an important question involving the proper reconciliation between the Exchange Act's scheme of supervised exchange self-regulation and the antitrust laws with respect to exchange practices subject to the review jurisdiction of the Commission. The question of whether exchange practices subject to the Commission's supervisory authority, including the fixing of commission rates, are exempt from the operation of the antitrust laws directly affects the ability of the Commission and of national securities ecchanges to perform their regulatory functions and thereby effectuate the statutory purposes of investor protection, fair dealing in securities and fair administration of exchanges (Section 19(b)). Fulfillment of these aims, as Congress recognized, are vital to the maintenance of investor confidence in the capital markets of this country and to the continued economic viability of the securities industry. See Section 2 of the Exchange Act, 15 U.S.C. 78b. While the Commission believes the decision below is correct, there is a conflict between circuits regarding the proper application of *Silver* to exchange rules over which the Commission has regulatory jurisdiction. Review by this Court is warranted to set a uniform, national standard concerning antitrust exemption.

1. In *Silver,* this Court ruled that the antitrust laws are to be repealed to the extent necessary to make the Securities Exchange Act work. 373 U.S. at 357. However, neither *Silver*—which involved a particular instance of enforcement of exchange rules over which the Commission had no review jurisdiction—nor any subsequent decision by this Court has applied this guiding principle for reconciliation of the two statutory schemes to potentially anti-competitive rules of a national securities exchange that are within the supervisory jurisdiction of the Commission under Section 19(b). Since the challenged exchange practice of fixing minimum commission rates falls clearly within those matters enumerated in Section 19(b), the proper application of the *Silver* principle to this case is presented on this record.

2. The decision of the Court of Appeals for the Seventh Circuit in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264, is in direct conflict with the decision below. In *Thill*, the court of appeals was presented with an antitrust challenge involving the New York Stock Exchange's former "anti-rebate rule"—a rule specifically intended to preserve the integrity of the exchange's fixed commission rate system by forbidding an exchange member from rebating to its customer or to a non-member broker any portion of the fixed commission. Thus, the anti-rebate rule was but an element of the fixed commission rate structure, would not have existed except in the context of such a rate structure, and clearly fell within the purview of the Commission's jurisdiction pursuant to Section 19(b)(9) and (13), 15 U.S.C. 78s-(b)(9) and (13). In contrast to the decision below, the *Thill* court held that "even the fact that the SEC

may be exercising its proper supervisory power over the rules of [a securities exchange] . . . does not in and of itself cloak [that exchange] . . . with antitrust immunity for its conduct relating to those rules." 433 F. 2d at 271. Rather "before a court may abdicate its jurisdiction on the antitrust issue the defendant [exchange] must establish its conduct as justified because it is necessary for the operation of the Securities [Exchange] Act." *Id.* at 273.

3. Resolution of the question of pre-emption of the antitrust laws in favor of the Commission's review power will have a material impact on the administration of the Exchange Act. If exchanges may be subject to antitrust liability for all conduct other than that which the Commission expressly directs, the willingness of exchanges to engage in self-regulatory activity will be substantially diminished. Similarly, the application of the antitrust laws to exchange rules within the Commission's Section 19(b) jurisdiction will necessarily affect the manner in which the Commission exercises its supervisory authority over national securities exchanges, not just with respect to stock exchange commission rates, but also as to the entire range of exchange activities made subject to its authority. The possibility of conflicting decrees by antitrust courts concerning self-regulatory activity subject to Commission supervision will necessarily limit the Commission's ability to formulate and effectuate a cohesive regulatory policy for the securities industry.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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I authorize the filing of the foregoing memorandum.

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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

against

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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SECURITIES AND EXCHANGE ACT OF 1934, Section 19b [15 USC 78s(b)] 2

IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

-against-

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITIONERS' BRIEF

Petitioner has moved for a writ of certiorari to the United States Court of Appeals for the Second Circuit in this case. The writ was granted by this Court and this brief is thus submitted on the merits.

OPINIONS OF THE COURTS BELOW

The District Court (*Gordon vs. New York Stock Exchange*, 366 Fed. Supp. 1261 dismissed the Complaint pursuant to Rules 12 and 56 of the Federal Rules of Civil Procedure, holding that the "fixed commission" rate structure of the defendant Stock Exchanges and Brokerage

firms was not subject to the anti-trust laws because of surveillance by the Securities and Exchange Commission. The United States Court of Appeals for the Second Circuit affirmed (498 Fed. (2nd) (1303).

JURISDICTION OF THIS COURT

This Court obtains jurisdiction to review the determination of the Court of Appeals for the Second Circuit pursuant to 28 USC 1254(1). The Petition for a Writ of Certiorari was filed within ninety (90) days from the date of the determination of the Court of Appeals. Jurisdiction to review was granted by Writ of Certiorari.

STATUTES INVOLVED

This case involves the consideration of the provisions of the anti-trust laws of the United States with the provisions of the Securities Acts of the United States. The pertinent statutes are as follows:

SHERMAN ACT, Section 1 [15 USC 1]

"Every contract, combination in the form of trust or otherwise, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal ***"

SHERMAN ACT, Section 2, [15 USC 2]

"Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor ***"

SECURITIES AND EXCHANGE ACT OF 1934, Section 19b[15 USC 78s(b)]

"The commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as *** (9) the fixing of reasonable rates of commission, interest, listing and other charges. ***"

THE QUESTION PRESENTED FOR REVIEW

Are the defendant Exchanges and the Broker Members of such Exchanges, entitled to fix minimum rates of commission even though ordinarily this would be a violation of the anti-trust laws, in view of the provisions of the Securities and Exchange Act of 1934, giving the Securities and Exchange Commission the powers set forth in 15 USC 78s(b)(9).

STATEMENT OF THE CASE

The record below consists of the Complaint, the Answers of the Defendants, and affidavits of the parties on the merits. All of the pertinent material is contained in the Appendix submitted herein. However it does appear to the plaintiffs that, while there are factual issues involved, the

primary question is one of law relating to the question set forth hereinabove.

ARGUMENT

THE DEFENDANT EXCHANGES AND THE BROKERAGE COMMUNITY ARE NOT EXEMPT FROM THE ANTI-TRUST LAWS SINCE SUCH EXEMPTION IS NOT NECESSARY TO MAKE THE SECURITIES ACT WORK. ALSO THE COMMISSION ITSELF, IN VARIOUS OTHER PROCEEDINGS, HAS STATED THAT IT HAS NO JURISDICTION OVER COMMISSION RATES AND HAS NEVER APPLIED THE POWERS GIVEN TO IT UNDER SECTION 19 OF THE SECURITIES AND EXCHANGE ACT OF 1934.

It is admitted that, without the Securities Act provisions, the fixation of minimum rates of commission together with penalties for the violation of such fixed rates, would be *per se* violations of the anti-trust laws. [*United States vs. Trenton Potteries Co.*, 273 US 392; *U.S. vs. Topco Associates, Inc.*, 405 US 596; *Northern Pacific Railway Co. vs. US.* 356 US 1, *Schwegmann Bros. vs. Calvert Distillers Corp.*, 341 US 384.

There is basically no dispute that, were it not for the Provisions of the Securities Acts, fixed brokerage commissions would be clearly illegal. The illegality is heightened by the fact that there are *penalties* against any Exchange Member for failing to observe the fixed rates. The Supreme Court of the United States in the leading case of *Silver vs. New York Stock Exchange*, 373 US 341, held that the Securities Industry is not a "regulated industry" which exempts it from the Anti-Trust Laws. However, this Court did state in *Silver* that if an exemption was necessary

in order to "make the Securities Acts work", such a situation might have to be considered at that time.

Kaplan vs. Lehman Brothers, 371 Fed 2nd 410, did hold that fixed Commission rates, since they were under the "supervision" of the SEC would be exempted from the Anti-Trust Laws. However, this case, a Seventh Circuit Determination was impliedly overruled by the later case of *Thill Securities Corp. vs. New York Stock Exchange*, 433 Fed 2nd 264. In *Thill*, (which is now sub judice by the United States District Court after remand by the Court of Appeals), the Attorney General of the United States has proposed the elimination of all fixed Commission rates as violations of the Anti-Trust Laws.

The Court's attention is also called to the later decided case of *Harwell vs. Growth Programs, Inc.*, 451 Fed 2nd 240.

The District Court took the position that the fixed Commission rates imposed by the Defendants herein were "approved" by the SEC and so were necessary in order to make the Securities Acts work. It is interesting to note, however, that the SEC, in two actions taken by the Plaintiff Independent Investor Protective League, specifically held that the Commission did not fix Commission rates. In a memorandum submitted to this Court, in Docket No. 71-1924, in support of the Commission's Application to Dismiss the League's Petition for Judicial Review of its' action with respect to certain Commission rates imposed by the Defendant Exchanges, had this to say:

> **** "In the present case, the Commission conducted no proceeding—let alone a proceeding "to which . . . [petitioners were] a party"—that could have resulted in "judicial action" by the Commission. The Commission's letter of comment to the Exchange did not order the Exchange, petitioners or any other person to do or to refrain

from doing anything. Nor did the letter "approve" or "disapprove" the Exchange's proposals. The letter was anything but a "definitive" determination "dealing with the merits" of the Exchange's rule amendments. ****"

In the subsequent Civil Action brought by the Independent Investor Protective League against the SEC, in the United States District Court for the District of Columbia, (Civil Action 1984-71), the Commission again denied that it had any power to fix Commission rates. Its' Brief read, in part, as follows:

**** "However, the question of the type and extent of immunity that may flow from Commission determinations regarding exchange rules and practices need not be decided in this case. The appropriate forum for resolution of that question is in an antitrust action against a self-regulatory organization challenging its rules or the administration of such rules. Indeed, plaintiffs recognize that they may seek to challenge exchange rules directly; they have instituted suit against the New York Stock Exchange for this very purpose. ****"

**** "The suggestion that the Commission has "approved" or "disapproved" any exchange rule or practice by its informal comment letters is refuted by the Act itself. Under the Act, the exclusive method by which the Commission may disapprove the rules of an exchange is a proceeding under Section 19(b) "to alter or supplement" such rules. This is highlighted by the quite different powers that Congress vested in the Commission with respect to the rules of national securities associations, the other major self-regulatory force in the securities industry. Section 15A(j) of the Act, 15 U.S.C. 78*o*-3(j), provides that a national

securities association must file any "change in or addition to" its rules before such rules take effect and that, if the proposed rules are inconsistent with specified provisions of the Act, "the Commission shall enter an order disapproving such change or addition. ****"

The latest determination by this Court with respect to the question of Administrative Agency jurisdiction suspending operation of the Anti-Trust Laws is *Otter Tail Power Company vs. United States,* 410 US 336, 93 Sup. Ct. 1022(1027) where this Court said:

"* * * Repeals of the antitrust laws by implication for a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions. (citing cases) Activities which come under the jurisdiction of a regulatory agency nevertheless may be subject to scrutiny under the antitrust laws.

See also *United States vs. Philadelphia National Bank,* 374 US 321, *California vs. FPC,* 369 US 482, *US vs. RCA,* 358 US 334.

CONCLUSION

THE MOTION TO DISMISS THE COMPLAINT SHOULD BE DENIED. THE MOTION FOR SUMMARY JUDGMENT DENIED. SUMMARY JUDGMENT SHOULD BE GRANTED IN FAVOR OF THE PLAINTIFFS OR, ALTERNATIVELY, THE CASE SHOULD BE REMANDED TO THE DISTRICT COURT FOR FURTHER PROCEEDINGS.

Respectfully submitted,

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No. 74-304

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OCTOBER TERM, 1974

RICHARD A. GORDON, etc.,
Petitioner,

against

NEW YORK STOCK EXCHANGE, INC., et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS

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February 19, 1975

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No. 74-304

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OCTOBER TERM, 1974

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—against—

NEW YORK STOCK EXCHANGE, INC., et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS

QUESTIONS PRESENTED

The issue presented here is not whether the defendant exchanges' long-standing and well-known rules fixing minimum commission rates to be charged by their members constitute unreasonable restraints of trade in violation of the antitrust laws. Rather, the sole issue presented is whether Section 19(b)(9) of the Securities Exchange Act of 1934 ("the Exchange Act") (48 Stat. 881 *et seq.*, 15 U.S.C. § 78a *et seq.*), impliedly repealed Section 1 of the Sherman

Antitrust Act of 1890 (26 Stat. 209, 15 U.S.C. § 1) with respect to such rules. More specifically, the questions are:

1. Whether the provisions of Section 19(b)(9) of the Exchange Act (15 U.S.C. § 78s(b)(9)), which authorize exchanges to adopt rules fixing reasonable rates of commission, are inconsistent with and repugnant to the Sherman Act's prohibition against rate-fixing so that the earlier statute must yield to the later.

2. Whether the provisions of Section 19(b)(9), which confer jurisdiction on the Securities and Exchange Commission (the "SEC") to review and require changes in exchange rules fixing rates if necessary to achieve the objectives of Section 19(b), exclude review jurisdiction over such rules by a court applying antitrust standards.*

The questions of whether the fixing of commissions was economically sound or justified, or whether the level of the rates fixed was reasonable, relate only to the exchanges' "rule of reason" defense if the antitrust laws apply but are irrelevant to the sole issue here involved of whether the antitrust laws apply at all to exchange commission rules.

JURISDICTION

Plaintiff's petition for a writ of certiorari was timely filed and defendants-respondents joined in the request for certiorari. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 19(b)(9) of the Exchange Act (15 U.S.C. § 78s (b)(9)) provides, in pertinent part:

"Sec. 19***(b) The Commission is further authorized, if after making appropriate request in writing

* The District Court decision, granting summary judgment in favor of defendants, is reported at 366 F.Supp. 1261 (S.D.N.Y. 1973). The decision below of the Court of Appeals, unanimously affirming the District Court's judgment, is reported at 498 F.2d 1303 (2d Cir. 1974). All references to the decision of the Court below will be by citation to the Appendix filed in this Court. Reference to the District Court's decision will be by citation to the Supplemental Appendix.

to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as*** (9) the fixing of reasonable rates of commission, interest, listing, and other charges;*** and (13) similar matters."

Section 1 of the Sherman Act (15 U.S.C. § 1) provides, in pertinent part:

"Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal:***"

COUNTER-STATEMENT OF THE CASE

A. Nature of the Case, Course of Proceedings and Disposition

This action was commenced on April 2, 1971, by Richard A. Gordon, individually and purportedly on behalf of an alleged class of investors, against the New York Stock Exchange, Inc. (the "NYSE"), the American Stock Exchange, Inc. (the "Amex"), and Merrill Lynch, Pierce, Fenner & Smith, Inc. and Bache & Co., Inc., as representatives of an alleged class consisting of the defendant exchanges' member organizations. The complaint (A-8 through A-22)* challenged as an illegal price-fixing con-

* References to (A-.....) are to the Appendix and references to (SA-.....) are to the Supplemental Appendix both filed in this Court.

spiracy the long established rules of the defendant exchanges* fixing minimum rates of commission to be charged by their members for transactions in securities listed on their exchanges.** Plaintiff sought injunctive relief, treble damages of $1.5 billion, and an attorney's fee of $10 million. (A-16).

Defendants' answers pleaded as affirmative defenses not only that the exchanges' rules fixing minimum commission rates were exempt from antitrust attack by reason of implied repeal of the Sherman Act by Section 19(b)(9) of the Exchange Act but also that, even in the absence of such implied repeal, such rules were justified under the "rule of reason." (A-20, 26, 33).

Defendants moved for summary judgment on the exemption defense alone. The District Court granted the motion and dismissed the complaint on that ground. The alternative "rule of reason" defense was not involved. (SA-453-465).

The Court of Appeals (per Kaufman, C.J.), rejecting the position of the Antitrust Division of the Department of Justice as *amicus curiae* in support of plaintiff, and adopting the position of the SEC as *amicus curiae* in support of defendants (A-450), unanimously affirmed the District Court's ruling. The grounds of affirmance were that under the rationale of this Court's opinion in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963), the Sherman Act was

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* While the complaint in this action limits its attack to the fixed minimum commission rules of the NYSE and the Amex, each of the other 11 registered national securities exchanges has rules fixing minimum rates of commission. *See* SEC Exchange Act Release No. 11073, CCH Fed. Sec. L. Rep. ¶ 79,991 at p. 84,522 (Oct. 24, 1974).

** The complaint also attacked the two exchanges' limitations on membership (A-9, 11-12) and pleaded violations of the Robinson-Patman Act (15 U.S.C. § 13(a) *et seq.*) (A-10; see A-12). These claims were dismissed as "essentially frivolous" by the Court below (A-439) and are now abandoned.

impliedly repealed by Section 19(b)(9) of the Exchange Act since the language and legislative history of that section, which permits exchanges to adopt and enforce rules fixing commission rates subject to SEC review and revision, demonstrates congressional intent to exempt such rules from review by an antitrust court under the Sherman Act. (A-442-445).

The Court below expressly disagreed, as did the District Court, with the contrary holding of the Court of Appeals for the Seventh Circuit in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971). (A-450-451; SA-464-465).

B. The Facts

As evidenced by the Appendix, the factual record before the Court below was ample. It was also undisputed.

Since their founding in 1792 and 1908, respectively, the NYSE and the Amex have at all times had rules, well known to the public, fixing minimum commissions to be charged by their members and member organizations* on transactions in securities listed on their exchanges. (A-42-43; 216-217).

In 1934 the NYSE and the Amex were registered by the SEC as national securities exchanges pursuant to Section 6 of the Exchange Act (15 U.S.C. § 78f) upon findings that the two exchanges' rules (including their minimum commission rules) were "just and adequate to insure fair dealing and to protect investors" and otherwise met the Exchange Act's standards. (A-43, 216-217, 229, 238-239).

Since registration in 1934 the defendant exchanges' commission rules have at all times been subject to the SEC's

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* Membership in the defendant exchanges is limited to individuals. "Member organizations" are "member firms" and "member corporations" in which at least one general partner or one director, owning voting stock, is an individual member of the NYSE or Amex.

powers of review and revision under Section 19(b) of the Exchange Act, which authorizes the SEC to request, and if necessary to require, changes in rules fixing commission rates to insure that they are "reasonable" and meet the other criteria of that section.

Since 1934 the NYSE and Amex, either with the approval or at the express direction of the SEC, have amended the provisions of their constitutions and rules prescribing minimum rates of commission a number of times. The most recent NYSE amendments were those which became effective on December 5, 1968, April 5, 1970, April 5, 1971, March 24, 1972, April 24, 1972, September 25, 1973, and February 24, 1974. (A-47-51; 217-218). In each instance the amendments were filed with the SEC not only at the time of their adoption as required under Section 6(a)(4) of the Exchange Act (15 U.S.C. § 78f(a)(4) (A-44), but also in proposed form well in advance of their effective dates, in accordance with SEC Rule 17a-8, in order to "afford an opportunity for orderly Commission consideration of exchange rules before they become effective." SEC Exchange Act Release No. 7253, CCH Fed. Sec. L. Rep. ¶ 76,973 at p. 81,617 (March 3, 1964). (A-39-40; 220-221).

The rules which plaintiff challenged specifically were those in effect from December 5, 1968, to April 5, 1971, and which (1) introduced a volume discount; (2) imposed a temporary service charge on so-called small transactions; and (3) permitted members to set their own rates of commission on portions of orders over $500,000. (A-223; A-47). All of these changes were made either at the specific behest or with the express approval of the SEC (A-220; 355; see generally A-45-52; 98-218; 221-228; 284-417).

On May 28, 1968, the SEC announced that, on the basis of its intensive study of the questions involved commencing as early as 1961, it had determined that "changes in the present commission rate structure are required to benefit the investing public" and ordered public hearings to be

held. (A-45-46; 218-219, 221, 240-248). Expressly invoking Section 19(b) of the Exchange Act, the SEC by letter of the same date requested the NYSE to make certain interim adjustments in its commission rate structure pending a final revision at the conclusion of public hearings. (A-221-222). The SEC sent a similar letter to the Amex. (A-45-46).

Thereafter, the SEC modified its request under Section 19(b) and approved changes in the rules of the defendant exchanges to provide a volume discount on all public orders involving more than 1,000 shares of stock. (A-47; 223).

The subsequent adoption of the interim service charge was also the result of meticulous inquiry and public hearings by the SEC, and was permitted on both exchanges for a limited time (April 1970 until March 1972) to afford relief to the brokerage industry then in financial crisis on condition that the exchanges would ensure that small investors were not discriminated against and that member organizations would take steps to ameliorate their financial problems. (A-223-224; 47; 119-157; 224-226; 48-49; 161-164).

Shortly after the introduction of the interim service charge in 1970, the SEC determined on the basis of its decade-long investigation of the commission rate structure, including two SEC reports (the *Special Study* of 1963 and the *Institutional Investor Study* of 1971)* and two years of testimony adduced at public hearings, in which the Antitrust Division actively participated, that fixed charges for portions of orders above a certain amount were no longer necessary or appropriate under the Exchange Act. (A-226; 350-352; 50; 185-186). In compliance with the SEC's de-

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* Report of the Special Study of Securities Markets of the Securities and Exchange Commission, House Doc. No. 95, 88th Cong., 1st Sess. (1963) and Institutional Investor Study Report of the Securities and Exchange Commission, House Doc. No. 92-64, 92d Cong., 1st Sess. (1971).

termination, the NYSE and the Amex each adopted changes in their constitutions in April 1971 which permitted their members to negotiate independently with customers with respect to commission rates on portions of orders in excess of $500,000, while retaining fixed minimum rates at levels below $500,000. (A-50; 206-207; 210; 226-227; 357-361).

Together with these changes in the commission rate structure the SEC approved repeal of the volume discount and the interim service charge and their replacement with a cost-related schedule of fixed commission rates for orders below $500,000 which incorporated a discount for volume transactions. (A-51; 210; 228; 409-410).

The SEC directed the defendant exchanges to monitor the impact of independently negotiated commission rates above the $500,000 level. (A-50-51; 227). After reviewing the monitoring data, the SEC, on February 2, 1972, announced its determination to lower the breakpoint for independent rate negotiation to $300,000 while again retaining fixed minimum rates at levels below $300,000. (A-51; 213-215; 227; 363-404). The NYSE and the Amex complied by making the necessary changes in their respective constitutions and rules, effective in April 1972. (A-51; 214-215; 227-228; 405-408).

• • •

Subsequent to defendants' motion for summary judgment, further action was taken by the SEC, the NYSE and the Amex in connection with the fixing of commissions. Because these matters are significant and of public record, they are described below.

On September 11, 1973, on the basis of its continuing investigation, the SEC announced that it would, in the exercise of its Section 19(b) authority, "act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt

rule changes achieving that result." SEC Exchange Act Release No. 10383, CCH Fed. Sec. L. Rep. ¶ 79,511 at p. 83,406 (Sept. 11, 1973). In explaining the reasons for this decision, the SEC stated that while the exchanges' system of fixed minimum commissions was authorized by the Exchange Act, because of changes in exchange trading patterns, notably the growth of institutional orders, the SEC had since 1968 looked to the introduction of competitive rates and believed that its policy of prudent gradualism in accomplishing that result now appeared to justify the abandonment of fixed commissions after April 30, 1975. SEC Exchange Act Release No. 10560, CCH Fed. Sec. L. Rep. ¶ 79,603 at p. 83,622 (Dec. 14, 1973).

In response to the SEC's request in February 1974 that the exchanges develop a program fostering "limited price competition" (SEC Exchange Act Release No. 10560, *supra*, at p. 83,622), the NYSE adopted changes in its constitution, effective April 1, 1974, to provide for the elimination of fixed commissions on orders of $2,000 or less. (New York Stock Exchange Member Firm Educational Circular No. 441, March 28, 1974). Similar changes were made in the constitution and rules of the Amex, also effective April 1, 1974. (American Stock Exchange Information Circular No. 29-74, March 29, 1974).

Subsequent to the decision by the Court below, the SEC, on September 19, 1974, invoking its powers under Section 19(b) of the Exchange Act, notified each of the registered national securities exchanges that "the rules and practices of such exchanges that require, or have the effect of requiring, exchange members to charge any person fixed minimum rates of commission, should be eliminated" and formally requested the exchanges to effect necessary changes in their constitutions, rules and practices to that end by November 1, 1974, to be effective on or before May 1, 1975. The SEC stated that if such action were not taken, "the [SEC] will commence appropriate proceedings

promptly to alter or amend the Constitution, rules and practices of such exchanges in the manner described above." SEC Exchange Act Release No. 11019, CCH Fed. Sec. L. Rep. ¶ 79,964 (Sept. 19, 1974).

The SEC thereafter promulgated proposed rules designed to eliminate exchange rules fixing commissions on all transactions and convened public hearings on November 18, 1974. SEC Exchange Act Release No. 11073, CCH Fed. Sec. L. Rep. ¶ 79,991 (Oct. 24, 1974); see also SEC Exchange Act Release No. 11093, CCH Fed. Sec. L. Rep. ¶ 80,007 (Nov. 8, 1974). Those hearings continued through December 17, 1974. On January 23, 1975, the SEC announced its policy conclusions and the adoption of a new rule (Rule 19b-3) providing for the elimination by May 1, 1975, of all exchange rules fixing minimum rates of commission to be charged by members on public transactions in securities listed on an exchange and subsequent elimination by May 1, 1976, of all exchange rules fixing minimum commission rates for intra-member transactions. SEC Exchange Act Release No. 11203 (Jan. 23, 1975); see SEC Rule 19b-3, CCH Fed. Sec. L. Rep. ¶ 79,991 (Jan. 23, 1975). On February 6, 1975, the Board of Directors of the NYSE voted to comply with Rule 19b-3. N. Y. Times, February 7, 1975, p. 39, col. 6.

In its policy conclusions supporting Rule 19b-3 the SEC, while strongly supporting its decision to require the complete abolition of fixed commissions, stated, with respect to the fixing of minimum commission rates by exchanges in the past:

> "The foregoing does not reflect any judgment by the Commission that the fixed minimum commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to earlier that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions, and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary." SEC Exchange Act Release No. 11203 at p. 26.

Culminating some three years of hearings and investigation, bills effecting a major revision of the Exchange Act which previously failed of passage are again pending before both houses of the Congress. Vol. 121, no. 1, Cong. Rec. H130 (daily ed. January 14, 1975); Vol. 121, no. 4 Cong. Rec. S376 (daily ed. January 17, 1975). Both the bill submitted in the House, H.R. 10, and the bill submitted in the Senate, S.249, seek, by amendment of Section 19(b)(9) of the Exchange Act, to provide for the future elimination of fixed commissions while vesting power in the SEC to permit the continuation of fixed rates under certain circumstances.

SUMMARY OF ARGUMENT

It is common ground that the issue of implied repeal—whether the Congress intended the antitrust laws to apply—is for a court to decide, and the Court below did so. But that issue is a question of law, not of fact.

The questions are simply whether provisions of the regulatory statute are so inconsistent as to be irreconcilable with the commands of the Sherman Act; and whether enforcement of the Sherman Act would intrude upon a domain exclusively marked out by the Congress for the regulatory agency. Under decisions of this Court resolution of these questions turns solely on the ascertainment of Congressional intent which, like all questions of statutory construction, is a matter of law. The Court below correctly adopted this approach.

Both the Solicitor General and the Court of Appeals for the Seventh Circuit in its *Thill* decision erroneously view

implied repeal as dependent on a rule of reason-type trial of economic and factual issues. But that type of inquiry is only appropriate to determine whether the antitrust laws have been violated in situations where they are applicable, not to determine the threshold question of whether they apply. This is precisely what this Court held in *Silver*, where, after deciding that self-regulatory conduct not subject to SEC review was not exempt from the antitrust laws, it ruled that such conduct was subject to the traditional antitrust rule of reason. The *Thill* decision is thus an aberration because it treats the issue of implied repeal as one of fact and, indeed, of policy: *i.e.*, whether the particular rule attacked is necessary to the proper functioning of the regulatory statute. This error stemmed from the *Thill* Court's misapprehension of the true nature of the "necessity" test of implied repeal delineated by this Court in *Silver*. This Court said the test was whether implied repeal of the Sherman Act was necessary to make the Exchange Act work; but the *Thill* Court said the test was whether the particular exchange rule was necessary to make the Act work.

More complete repugnancy between two statutory schemes would be difficult to imagine. Section 19(b)(9) of the Exchange Act authorizes exchanges (organizations of competing brokers) to fix rates of commission, whereas the Sherman Act prohibits rate-fixing by competitors. The same section vests in the SEC jurisdiction to exercise continuing control over this authorized rate-fixing and to require changes in exchange rules fixing commission rates, whereas enforcement of the Sherman Act prohibition against unreasonable restraints of trade is vested in the courts. Section 19(b)(9) is a deliberate exception, as to one specific aspect of a particular regulated industry, to the Sherman Act's pro-competitive policy. The Sherman Act must therefore yield to the subsequent and inconsistent expression of Congressional intent embodied in the Exchange Act.

The *Thill* decision was also in error in holding that the existence of SEC review jurisdiction is not by itself sufficient to establish an implied repeal but a rule-of-reason trial must be held to determine whether the SEC has actively and adequately exercised that jurisdiction. Even if this aspect of the *Thill* interpretation of this Court's *Silver* opinion were correct; that test is more than adequately met by the ample and undisputed evidence in the record. That evidence shows that the SEC has for over a decade actively exercised its review jurisdiction, with the participation of the Antitrust Division, with respect to numerous aspects of the level and structure of commission rates, and has recently ordered the elimination by May 1, 1975, of all exchange rules fixing commissions to be charged non-members, subject to the presently unforeseen possibility of a return to some form of fixed rates.

Principles of public utility regulation have no bearing on the unique system of cooperative SEC-exchange regulation, in which the exchanges take the initiative in adopting rules and the SEC exercises an oversight role. But even if the existence of "pervasive" regulatory power were essential to implied repeal, that test is met here. Regardless whether the entire scheme of the Exchange Act is of "pervasive" regulation, the SEC's power over exchange-fixed commission rates under Section 19(b) of the Act could not be more pervasive. Under that section the SEC has power not only to regulate, as it has done in the past by changing the level and structure of exchange-fixed commission rates, but also power which it has now exercised effective May 1, 1975, to abolish completely the practice of fixing rates, subject to possible reinstitution of some form of fixed rates in the future.

If exchange-fixed minimum commission rates had been unlawful since passage in 1890 of the Sherman Act, despite enactment in 1934 of the Exchange Act and its Section 19(b)(9), it is difficult to understand why the Congress for

the past three years has considered and is still considering amendments to the Exchange Act to outlaw commission fixing, subject to its possible reintroduction by the SEC. Ordinarily, the Congress does not legislate to prohibit conduct which is already unlawful. The inference is irresistible that by considering such amendments to the Exchange Act the Congress has implicitly reaffirmed the intent of the Congreess which enacted the Exchange Act to authorize exchange rate-fixing subject to SEC oversight and thereby to repeal the Sherman Act *pro tanto*.

ARGUMENT

I.

In enacting Section 19(b) of the Exchange Act the Congress intended to repeal *pro tanto* the inconsistent pre-existing provisions of the Sherman Act.

A. The Question of Implied Repeal is a Question of Law.

It is undisputed (see S.G.Br., pp. 10-12) that the SEC cannot grant exchanges exemptions from the antitrust laws and that the question of implied repeal is for a court to decide. It is likewise agreed, in light of this Court's decisions* (S.G. Br., pp. 4, 12, 13 and 37; see also, pp. 26-43)

* Implied repeal presents a question of law, to be decided exclusively by reference to the explicit or inferred congressional intent behind a statute enacted subsequent to the Sherman Act, and not by reference to extrinsic economic evidence relating to the wisdom of the alleged restraint of trade involved. *See e.g.*, Hughes Tool Co. v. Trans World Airlines, Inc., 409 U.S. 363, 379 (1973); Pan American World Airways v. United States, 371 U.S. 296, 304, 305, 309-10 (1963); McLean Trucking Co. v. United States, 321 U.S. 67, 79 (1944); Keogh v. Chicago & Northwestern Ry. Co., 260 U.S. 156, 161-63 (1922); Texas & Pacific Ry. v. Abilene Cotton Oil Co., 204 U.S. 426, 437, 446 (1907). Indeed, this is the position espoused by the Solicitor General in his brief in United States v. NASD, Dkt. No. 73-1701 *prob. juris noted*, 43 U.S.L.W. 3185 (U.S. Oct. 15, 1974) (presently before this Court), in which no suggestion is made that implied repeal of the Sherman Act turns on the outcome of a trial of issues of fact and a "rule of reason" analysis.

that the question of implied repeal is traditionally an issue of law to be determined by the Congressional intent to be inferred from the language, structure and relevant history of Section 19(b)(9) of the Exchange Act. Irrelevant to this question is a factual determination as to the economic or regulatory necessity of rate-fixing, which is a policy determination within the province of the Congress and the SEC.

It is further agreed (S.G.Br., pp. 4, 12, 48; see also, pp. 14 and 22) that the traditional and proper tests of a *pro tanto* implied repeal are whether a clear repugnancy exists between the antitrust laws and a subsequent regulatory enactment or whether there is an irreconciliable conflict between the jurisdiction of an antitrust court and the regulatory power delegated by the Congress to an agency.

At this point the issue fundamental to this appeal arises. The Solicitor General argues (S.G.Br., pp. 4, 10, 11, 15-16, 24-26) that this Court's decision in *Silver* has converted the traditional question of statutory interpretation on the issue of implied repeal into a question of fact as regards repeals to be implied from provisions of the Exchange Act. It is urged (S.G. Br. *ibid.*) that *Silver* established the question of necessity in terms of Exchange Act objectives as a new and special test of implied repeal which, it is claimed, is "an aspect of the rule of reason."

The argument stems from a misreading of this Court's opinion in *Silver*, which said nothing of the kind. In *Silver* this Court first decided—as a matter of law, by reference to the relevant provisions of the Exchange Act and its legislative history, and without reference to any factual record on the issue of Exchange Act necessity—that, in part because of the absence of any provision in the Exchange Act giving the SEC power to review the particular self-regulatory conduct there challenged (the particular application of a rule rather than the rule itself) the Sherman Act had not been impliedly repealed as to that particular conduct. 373

U.S. at 357-58. The Court reached this result without applying any "rule of reason" or other principle of antitrust law. Only after it had ruled that no repeal could be implied so as to exempt the particular conduct attacked did the Court proceed to analyze the conduct itself to ascertain whether it was justified under the "rule of reason," *i.e.*, in terms of the objectives of the Exchange Act. 373 U.S. at 360-62. Thus, the "rule of reason" was not utilized as a test of implied repeal but to determine whether the antitrust laws had been violated.

This Court's treatment of the implied repeal issue in *Silver* as a question of law dependent on construction of the Exchange Act was thus wholly consistent with the approach to that issue repeatedly taken in other decisions of the Court, both prior and subsequent. Where antitrust exemptions have not been explicitly set forth in regulatory statutes, a Congressional intent to exempt challenged regulatory conduct from the antitrust laws is nonetheless to be inferred, in particular and discrete instances, where either the terms of the statute are in conflict with the prohibitions of the antitrust laws or where the goals or effective operation of the regulatory statute would be frustrated unless a *pro tanto* repeal of the antitrust laws were implied. *E.g.*, *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 379 (1973); *Pan American World Airways* v. *United States*, 371 U.S. 296, 304, 305, 309-310 (1963); *Keogh* v. *Chicago & Northwestern Ry. Co.*, 260 U.S. 156, 161-63 (1922); *Texas & Pacific Ry. Co.* v. *Abilene Cotton Oil Co.*, 204 U.S. 426, 437, 446 (1907); see, *e.g.*, *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *FMC* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 732 (1973); *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963); *Georgia* v. *Pennsylvania R.R. Co.*, 324 U.S. 439, 456-457 (1945); *United States* v. *Borden Co.*, 308 U.S. 188, 198, 199 (1939).

Here, an implied repeal of Section 1 of the Sherman Act by Section 19(b)(9) of the Exchange Act is dictated

by two considerations: first, the explicit rate-fixing authorization contained in Section 19(b)(9) is repugnant to the prohibition against rate-fixing contained in Section 1 of the Sherman Act (15 U.S.C. § 1); and second, the creation of on-going supervisory power in the SEC over exchange rules fixing commission rates is inconsistent with review of such rules by a court under the antitrust laws.

B. Section 19(b)(9) of the Exchange Act Cannot be Reconciled with the Sherman Act.

1. Section 19(b)(9) Authorizes Exchanges to Adopt Rules Fixing Commission Rates.

In *Silver* this Court referred to Section 19(b) as suggesting the general dimensions of the exchanges' "federally mandated duty" of self-regulation, 373 U.S. at 352-53, and even the *Thill* Court acknowledged that in many respects exchanges have been "delegated governmental authority." 433 F.2d at 266.

Section 19(b) on its face includes the "fixing of reasonable rates of commission" among those self-regulatory activities in which exchanges are authorized to engage.

In granting the SEC the power under Section 19(b)(9) to review exchange rules fixing rates of commission to assure the reasonableness of those rates as well as fulfillment of the other statutory objectives, the Congress manifestly contemplated action by the SEC with respect to rates already set by an exchange. Otherwise there would be nothing for the SEC's review power to act upon. (See p. 26, *infra*). This is also apparent from the statutory requirement that the SEC, as a prerequisite to ordering any revision in rules fixing commissions, must first request an

exchange to "effect on its own behalf" any suggested "changes in its rules and practices".*

Section 3(a)(3) of the Exchange Act (15 U.S.C. § 78c(a)(3)), which is ignored by the Solicitor General, reinforces the view that the Congress intended to authorize exchange rate-fixing and also evidences an intent that such rates be minimum rates. Section 3(a)(3) defines a "member" of a registered national exchange as any person who is permitted to effect transactions on an exchange, *inter alia,* "with payment of a commission or fee which is less than that charged the general public." This provision obviously contemplates that commission rates to be charged the general public will be fixed minimum rates since in the absence of such a minimum rate there would be no basis for determining whether the commission charged a member was "less than" that charged the general public.

Both the Congress and the SEC have so interpreted Section 3(a)(3).

In introducing H.R. 5050 in 1973 (the so-called Moss Subcommittee Bill now pending before the House as H.R. 10), designed, *inter alia,* to repeal the commission rate-fixing authorization in Section 19(b)(9), Representative Moss explained the need for a simultaneous revision of Section 3(a)(3) as follows:

> "Current law includes within this definition [of a member] a person who can make use of the facilities of an exchange to execute a transaction at the so-called 'intra-member rate' (a rate less than the fixed minimum commission rate charged the general public). Since the bill abolishes all fixed minimum commissions, this part of the definition of 'member' is stricken and a new definitional section is added . . . .
>
> "This amendment shall take effect . . . coincident with the mandatory phase-out of fixed rates." (199 Cong. Rec., H1316, March 1, 1973)*

* The Solicitor General implicitly acknowledges the existence of statutory rate-fixing authority (S.G. Br., p. 37) but argues that it does not exclude antitrust review by a court. In so doing he abandons the position urged by the Antitrust Division as *amicus curiae* in the Court below that while Section 19(b)(9) authorizes fixing of "reasonable" rates such rates can only be maximum rates. This position was demolished by the SEC in its brief as *amicus curiae* (pp. 18-19) in Kaplan v. Lehman Bros. 371 F.2d 409 (7th Cir.), *cert. denied,* 389 U.S. 954 (1967)—copies of which have been lodged with this Court—was rejected by the Seventh Circuit in that case ("Obviously the fixing of minimum commissions is one method of regulating commission rates." 371 F.2d at 411) and was apparently found so lacking in merit that it was ignored in the opinion of the Court below.

Both the District Court and the Court below ruled that in enacting Section 19(b)(9) the Congress, in the plainest of terms, authorized exchanges to adopt rules fixing commission rates. The District Court said that the "facial language of the Exchange Act gives the Exchange and the Commission the power to 'fix' commission rates." (SA-461). The Court of Appeals, in turn, said that "the 1934 Act explicitly provides for 'the *fixing* of reasonable rates of commission'." (A-439) (emphasis in original).

While acknowledging that where an earlier law is clearly repugnant to a later law, the earlier must give way (S.G.Br., p. 12), the Solicitor General argues that a determination of repugnancy cannot be made in this case without a trial on the issue of whether the fixing of commissions is "necessary" (S.G.Br., pp. 17, 25-26). This argument finds no support in *Silver* (which was itself a summary judgment case), runs counter to all of the implied repeal decisions of this Court, and also is contrary to logic. A clear repugnancy between two statutes either appears from the language used by the Congress or it does not exist.

The Solicitor General also argues (S.G.Br., p. 37) that no repugnancy here exists because "the statutory language itself does not require a fixed commission system." But exempt rate-fixing under regulatory statutes is typically permissive and not mandatory. See, *e.g.,* Interstate Com-

* As to the SEC's views on Section 3(a)(3), see p. 26, *infra.*

merce Act, 49 U.S.C. § 15(1); Civil Aeronautics Act, 49 U.S.C. §§ 1482(d) and (e); Shipping Act, 46 U.S.C. § 817. Hence, the absence of a requirement that exchanges fix commissions does not negative an implied repeal of the prohibition against price-fixing contained in the Sherman Act. See *In re Permian Basin Area Rate Cases,* 390 U.S. 747, 767-68, 774-76, 790, 800 (1968); *Pennsylvania Water & Power Co.* v. *FPC,* 193 F.2d 230, 234-35 (D.C. Cir. 1951), *aff'd,* 343 U.S. 414 (1952).

Presumably, in enforcing the Sherman Act for over eighty years prior to its first challenge of commission rate-fixing by exchanges in *Thill,* the Antitrust Division must have likewise viewed exchange rate-fixing as authorized. Even in the *Thill* case, on which the Solicitor General relies so heavily, the Seventh Circuit described exchange rate-fixing as a "system of authorized price-fixing." 433 F.2d at 270. However, the most that the Solicitor General is now prepared to concede is that "particular instances of price fixing" by exchanges might be "necessary" (S.G.Br., p. 2). This position finds no support in either the language of Section 19(b)(9) ("rules and practices . . . in respect of such matters as . . . the fixing of reasonable rates of commission") or established antitrust principles.

2. The Legislative History of Section 19(b)(9) Demonstrates Congressional Intent that Exchanges Continue to Fix Commission Rates.

The legislative history of Section 19(b)(9) supports the holding of the Court below that the Congress intended to authorize by statute continuation of the exchanges' historic practice of fixing rates of commission, subject only to newly created jurisdiction in the SEC to review and revise such rates.

The Congress had long been aware of the general practice followed by all of the nation's securities exchanges of

setting minimum rates of commission. In 1913, the House Committee on Banking and Currency, headed by Congressman A. P. Pujo, which was considering possible federal regulation of stock exchanges, conducted a broad investigation of many matters, including the operations of the NYSE. The report submitted by the Pujo Committee noted that the fixed minimum commission rule was strictly enforced by the NYSE and that "[t]he acknowledged objective is to prevent competition amongst the members." *Report of the Committee Appointed Pursuant to House Resotions 429 and 504 to Investigate the Concentration of Control of Money and Credit,* H.R. Rep. No. 1593, 62d Cong., 2d Sess. 39 (1913). The Committee did not merely indicate an awareness of prevailing practice; it went on to approve it:

> "As regards the rates of commission enforced by the exchange your Committee believes the present rates to be reasonable, except as to stocks, say, of $25 or less in value, and that the exchange should be protected in this respect by the law under which it shall be incorporated against a kind of competition between members that would lower the service and threaten the responsibility of members." (*Id.* at 115).

When the Exchange Act was under consideration by the Congress some twenty years later, in testimony before the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce, the long-standing practice of exchanges of fixing minimum commission rates was repeatedly referred to both by members of those committees as well as by witnesses representing the various exchanges. See *Hearings Before Senate Committee on Banking and Currency on Stock Exchange Practices,* 73rd Cong., 2d Sess., Pt. 13, 6075, 6080 (1934); *Hearings Before House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720,* 73rd Cong., 2d Sess., pp. 320-31, 423-24 (1934). Similarly, the exchanges' prac-

tice of fixing minimum commission rates was specifically and repeatedly mentioned in the House and Senate debates. See 78 Cong. Rec., 8087, 8092, 8490, 8493-94 (1934).

What eventually became Section 19(b)(9) was originally contained in Section 18(c) of two separate bills, S. 2693 and H.R. 7852 (73rd Cong.), which provided:

> "The [Federal Trade] Commission may fix or prescribe the method of fixing uniform rates of commission."

It is true that the word "uniform" was later replaced by the word "reasonable", presumably at the suggestion of Mr. Samuel Untermyer (S.G. Br., pp. 30-31), who argued that the bill should make it clear that the Commission itself could fix rates. However, the important point is that the Congress did not adopt the suggestion that a government agency be empowered to fix rates, but instead adopted the language of Section 19(b)(9) continuing this power in the exchanges, with the SEC having review authority.

The Court below correctly inferred (A-443-444; see A-449-450) that the Congress intended to render inapplicable to exchange rate-fixing this Court's decision in *United States* v. *Trenton Potteries Co.*, 273 U.S. 392 (1927). The Solicitor General attempts to cast doubt on this inference by suggesting that in 1934 it was still unclear whether "exchange transactions were within the reach of the Federal Commerce Power." (S.G. Br., p. 47) But this doubt can hardly be ascribed to a Congress which was using that very power to enact the Exchange Act and thereby to regulate exchanges.

Recent Congressional activity adds further support to the conclusion by the Court below that Section 19(b)(9) was intended to permit rate-fixing by exchanges. The District

Court, after reviewing the then pending legislation, reintroduced in the current session, remarked:

> "Moreover, recent developments in Congress regarding the commission structure support the holding here. The Senate recently rejected amendments to the 1934 Act which would have mandated the elimination of fixed commissions within two years. See 119 Cong. Record, S11385-6, June 18, 1973. It is reasonable to infer from the proposal of these amendments that Congress did not believe fixed commissions were already illegal under the anti-trust laws, and, of course, the rejection of the amendments suggests that Congress does not now regard fixed rates as offensive to the Exchange Act or the anti-trust laws." (SA-464).

Obviously, if exchange rate-fixing were already illegal, the Congress would not be debating proposed legislation to prohibit such conduct. In particular, it would not be considering amendments of Section 19(b)(9) of the Exchange Act to strike the word "commission" and of Section 3(a)(3) to redefine the term "member" if it did not believe that these provisions authorize exchange rate-fixing, which the sponsors of the proposed legislation are seeking to eliminate.*

The Solicitor General argues from the express prohibition against commission rate-fixing by associations of securities brokers or dealers contained in the 1938 Maloney Act amendment to the Exchange Act that the Congress did not intend to exempt rate-fixing by registered exchanges from the antitrust laws (S.G. Br., pp. 32-35). But the Maloney Act proves precisely the contrary.

The Maloney Act amendment, adopted some four years after the Exchange Act, for the first time authorized the

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*See discussion at pp. 11, 18-19, *supra*.

establishment of associations of brokers and dealers operating in the over-the-counter market and placed them under SEC supervision. Section 15A(b)(7) of the Maloney Act (15 U.S.C. § 78o-3(b)(7)), providing that rules of such associations may not "impose any schedules or fix minimum rates of commission," marked a deliberate distinction between the over-the-counter market (essentially a dealer market) and the registered exchange auction markets, essentially broker markets. It was because, in the absence of such an express prohibition, newly organized associations registered under the Maloney Act might have been assumed to have the same rate-fixing power as historically exercised by exchanges, that the Congress negated any such authority. Exchanges, on the one hand, and associations operating in the over-the-counter market, on the other, were recognized as serving basically different purposes and were therefore endowed by the Congress with different powers.

As noted by the SEC in its brief as *amicus curiae* (p. 30, fn. 53) in the *Kaplan* case, the Maloney Act makes it clear that when dealing with a situation where the Congress felt it in the public interest to prohibit commission rate-fixing it specifically did so. In amending the Exchange Act in 1938 and expressly prohibiting the fixing of commissions by newly formed associations of brokers and dealers, the Congress deliberately chose not to amend Section 19(b)(9) to prohibit fixing of commissions by exchanges, as it could easily have done if it had intended that result.

3. The SEC Has Consistently Intepreted Section 19(b)(9) as Authorizing Continued Exchange Rate-Fixing.

Under well-recognized principles, the "contemporaneous administrative construction" must "carry the day against doubts that might exist from a reading of the bare words of a statute." *FHA* v. *The Darlington, Inc.*, 358 U.S. 84, 90 (1958); see *United States* v. *American Trucking Assns, Inc.*, 310 U.S. 534, 549 (1940); *Norwegian Nitrogen Products*

Co. v. *United States*, 288 U.S. 294, 315 (1933); *cf.*, *Volkswagenwerk Aktiengesellschaft* v. *FMC*, 390 U.S. 261, 272 (1968).

Since the adoption of the Exchange Act, the SEC has consistently interpreted Section 19(b)(9) as vesting in exchanges rate-making authority subject to the SEC's power to order changes or modifications.

In its 1963 Report of the Special Study of Securities Markets ("Spec. Study"), House Doc. No. 95, 88th Cong., 1st Sess., the SEC said:

> "Both the level and structure of commission rates are established by rules of the various exchanges and are encompassed in the Commission's statutory authority with respect to 'the fixing of reasonable rates of commission' (sec. 19(b)(9) of the Exchange Act)." (Spec. Study Pt. 2, p. 294)
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> • • •
>
> ". . . the statutory scheme . . . vests ratemaking initiative in the exchanges and a residual, albeit continuing, responsibility of oversight in the Commission." (Spec. Study Pt. 2, p. 329)
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> • • •
>
> ". . . The first step is that an exchange adopts rules fixing rates of commission. If changes are deemed necessary or appropriate, the Commission is to present an 'appropriate request' in writing for specified changes. Compliance by the exchange presumably ends the matter, but if the exchange does not accede, the Commission is empowered, after appropriate notice and opportunity for hearing, 'by rules of [sic] regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of *** (9) the

fixing of 'reasonable' rates of commission***.' " (Spec. Study Pt. 2, p. 344)

In its 1966 *amicus* brief in the *Kaplan* case the SEC observed:

> "These provisions of the Exchange Act [§§ 3(a)(3) and 19(b)(9)] make it plain that while broad supervisory and residual powers and ultimate regulatory jurisdiction over the areas enumerated by Section 19(b) rest with the Commission, Congress imposed directly on the exchanges themselves the duty to take the regulatory initiative in enacting rules which conform to the standards of the Act. Since Section 19(b)(9) expressly vests the Commission with power to alter or supplement the rules of an exchange in respect of 'the fixing of reasonable rates of commission,' it follows that Congress contemplated that exchanges would have and enforce such rules . . . The Congressional intent that the exchanges have and enforce rules establishing commission rates is also evidenced by Section 3(a)(3) of the Exchange Act, 15 U.S.C. 78c(a)(3), which defines the term 'member,' when used with respect to an exchange, as, among other things, a person who is permitted to make use of the facilities of the exchange without the payment of a commission or fee or 'with the payment of a commission or fee which is less than that charged the general public.' This presupposes that commissions or fees would be established collectively in some way by members of an exchange and further that members would pay lower commissions than nonmembers, a result which would hardly follow if the commissions paid by everyone were determined individually by each member." (p. 15).

More recently, on December 14, 1973, the SEC reiterated this view:

> "[T]o the extent any such rules are appropriate, the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted." SEC Exchange Act Release No. 10560, *supra*, CCH Fed. Sec. L. Rep. ¶ 79,603, at p. 83,620.

• • •

Thus, it is clear from the face of Section 19(b)(9), from its legislative history and from its consistent interpretation by the SEC that the Congress, far from outlawing rules of exchanges fixing minimum rates of commission or rendering them subject to the Sherman Act's stringent prohibitions against rate-fixing, deliberately included this long-standing practice within the scope of an exchange's self-regulatory authority, subject to review and revision by the SEC, and therefore by implication necessarily repealed the Sherman Act *pro tanto*.

The Court below, in reaching its decision that a repeal of the Sherman Act was necessarily implied in this case, was thus on firm ground when it said, after a careful and extensive consideration of the Exchange Act and its history:

> "Exemption from the antitrust laws with regard to the fixing of minimum rates of commission is . . . mandated by both the language and the legislative history of the 1934 Act, and in particular § 19(b) (9) . . ." (A-44-45).

Contrary to the Solicitor General's assertion (S.G.Br., p. 13), the Court below did not ignore the "guiding principle" of implied repeal set forth in *Silver*. That guiding principle is the familiar one that, while repeals by implication are not favored, they will nevertheless be found where the later statute is plainly inconsistent with the earlier one. (See pp. 15-16, *supra*).

The Court below not only properly applied *Silver* but also correctly followed this Court's more recent application

of the implied repeal doctrine in *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973), in which it was said:

> "The *Pan American* case is consistent with the view expressed in Silver v. New York Stock Exchange, 373 U.S. 341, 360-361, that while [sic] a statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances by implication grant immunity from an antitrust claim." 409 U.S. at 385, n. 14.

The decision below is also squarely in accord with an earlier decision by the Seventh Circuit on the very same issue involved here, which held exchange commission rate-fixing exempt from the antitrust laws. *Kaplan* v. *Lehman Bros.*, 250 F. Supp. 562 (N. D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967).

4. The *Thill* Decision Misapplied the Traditional Test of Implied Repeal of the Antitrust Laws.

Plaintiff and the Solicitor General (P.Br., p. 5; S.G. Br., pp. 15, 16, 24, 25) rely heavily on *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971), with which the Court below disagreed in part because the *Thill* Court had misconstrued this Court's restatement in *Silver* of the traditional test of implied repeal by confusing implied repeal with the particular rule involved in applying the "necessity" test.* In *Silver*, this Court declared:

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* The Solicitor General also cites (S.G. Br., pp. 15, 24, 26, 34-35, 45) Harwell v. Growth Programs, Inc., 451 F.2d 240 (5th Cir.), *opinion on reh'g*, 459 F.2d 461, *cert. denied*, 409 U.S. 876 (1972); Fredrickson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 5 CCH Trade Reg. Rep. 1974-2 Trade Cas. ¶ 75,227 (N.D. Ill. Sept. 9, 1974), *interlocutory appeal stayed pending this Court's decision herein*, Dkt. No. 74-2030 (7th Cir., order entered Jan. 3, 1975); Zuckerman v. Yount, 362 F. Supp. 858 (N.D. Ill. 1973). But these three cases, two of which were decided by District Courts in the Seventh Circuit, did not more than follow *Thill's* erroneous reasoning.

> "Repeal is to be . . . implied only if necessary to make the Securities Exchange Act work, . . ." 373 U.S. at 357.

But the Seventh Circuit said that repeal is to be implied only if an exchange

> ". . . establish[es] its anticompetitive conduct as justified because it is necessary for the operation of the Securities [sic] Act.
>
> • • •
>
> "[an exchange is] required to establish, if possible, that the conduct complained of was necessary to make the Securities [sic] Act work." 433 F.2d at 273.

In *Thill*, while not attacking the practice of minimum rate-fixing as such, the plaintiff, a non-member broker, claimed that the NYSE had violated the antitrust laws by prohibiting its members from sharing commissions with non-members (including non-member brokers) or granting to non-members any rebate or discount from the fixed minimum rate (the so-called "anti-rebate rule"). The District Court, relying on this Court's decision in *Silver* and on the Seventh Circuit's decision in *Kaplan*, granted summary judgment in favor of the NYSE on the ground that the anti-rebate rule, being an integral and necessary part of the NYSE's minimum commission rules, was likewise exempt from the Sherman Act by reason of Section 19(b)(9) of the Exchange Act. CCH 1969 Trade Cas. ¶ 72,911 (E.D. Wis., Aug. 26, 1969) (not officially reported).

The Court of Appeals for the Seventh Circuit—by a 2 to 1 decision, generating three separate opinions—reversed. It held that before repeal of the antitrust laws by the Exchange Act could be implied, there had to be a trial in which the NYSE had the burden of proving that its anti-rebate rule was necessary to make the Exchange Act work.

Judge Campbell, writing for the majority in *Thill*, attempted to distinguish *Kaplan*—as does the Solicitor Gen-

eral (S.G. Br., pp. 24-26)—as holding only that exchange rules fixing commissions are not subject to attack as *per se* illegal under the Sherman Act. 433 F.2d at 268-69. But when read as a whole, the decision of the District Court in *Kaplan* (affirmed in a brief opinion by the Seventh Circuit) cannot be so understood. What the Court was clearly saying was that the fixing of rates, as such, because expressly authorized by Section 19(b)(9), could not be held illegal, nor could the level of the rates be subjected to antitrust review by a court. There is simply no other way to read the *Kaplan* case, or to distinguish it from the *Thill* case, and Judge Pell's dissent in the *Thill* case makes this very point. 433 F.2d at 277-78.

Significantly, in its recent decision in *Schaefer* v. *First National Bank of Lincolnwood,* decided January 30, 1975, 5 CCH Trade Reg. Rep., 1975 Trade Cas. ¶ 60,137 at p. 65,379, the Seventh Circuit, in dismissing an antitrust claim, said, ignoring *Thill,* that "Private parties may only bring antitrust claims against an exchange or its members when there is no other vehicle for review."

II.

By giving the SEC the power to review and revise exchange rules fixing commission rates under standards of the Exchange Act, the Congress likewise manifested its intention to exclude review and revision by a court applying antitrust standards.

The plain repugnancy between Section 19(b)(9) of the Exchange Act and the Sherman Act dictates the conclusion that the Congress intended to repeal, by implication, the latter statute as regards the practice of exchange rate-fixing. This conclusion is buttressed by the presence of agency review power over that practice.

A. The Grant of Agency Review Power Over Commission Rates Precludes Judicial Review Under the Antitrust Laws.

In *Silver,* this Court, in holding that the NYSE's severance of the plaintiff's private wire connections to NYSE members was not exempt from the antitrust laws, emphasized the importance of the fact that the SEC lacked the power to review this aspect of the NYSE's regulatory activity. It concluded that this lack of SEC jurisdiction removed the serious concern that assertion of antitrust jurisdiction could otherwise create a "conflict of coextensiveness with the agency's regulatory power," thereby rendering the self-regulatory scheme ineffective. 373 U.S. at 358.

The Solicitor General erroneously infers that the absence of SEC review power made it "unnecessary to consider whether the primary jurisdiction doctrine was applicable." (S.G. Br., p. 18). A fair reading of *Silver* makes it clear that it was not a "primary jurisdiction" case, but an "exclusive jurisdiction" or "exemption" case, and the Court found no need to consider the doctrine of primary jurisdiction. 373 U.S. at 358. The Court clearly saw SEC jurisdiction as relevant to the exemption issue:

> "Should review of Exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" 373 U.S. at 360.

In note 12 the Court said:

> "Were there commission jurisdiction and ensuing judicial review for scrutiny of a particular exchange ruling, . . . a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity, an issue we do not decide today." 373 U.S. at 358, n. 12.*

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* In arguing that the "different case" reserved in *Silver* was a case of primary jurisdiction, the Solicitor General omits and necessarily overlooks the last, and obviously crucial, part of this sentence regarding exemption. (S.G. Br., p. 19).

Thus, in holding that the presence of SEC power to review exchange rules fixing commissions made theirs the "different cases" as to antitrust exemption—not as to primary jurisdiction—the Seventh Circuit in *Kaplan* and the Court below in this case correctly applied this Court's rationale in *Silver*.

The Solicitor General, however, argues (S.G. Br., p. 20) that *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289 (1973), is *Silver's* "different case", even though *Ricci* did not reach the issue of implied repeal but dealt only with primary jurisdiction. What Ricci complained of was that the Chicago Mercantile Exchange had improperly transferred his membership to another trader, by means of a blank transfer authorization that had allegedly previously been revoked. The complaint charged that this action violated the rules of the Chicago Mercantile Exchange, the Commodities Exchange Act and, almost as an afterthought, the antitrust laws. 409 U.S. at 290-91.

The Seventh Circuit, *sua sponte,* issued a stay and directed referral of the case to the Commodities Exchange Commission. This Court affirmed, giving three reasons: 1) the district court, in subsequent proceedings, would have to determine whether the regulatory scheme of the Commodity Exchange Act was incompatible with the maintenance of an antitrust action based upon self-regulatory conduct undertaken pursuant to that Act; 2) some aspects of the antitrust dispute were concededly within the statutory jurisdiction of the Commission; and, 3) "adjudication of [the facts in] dispute by the [Commission] promise to be of material aid in resolving the immunity question." 409 U.S. at 302.

In *Ricci* this Court did not rule on the claim of antitrust exemption. All that this Court suggested was that, based on the facts to be developed by the Commission on the primary jurisdiction reference, a court would be in a

better position, if any further proceedings were necessary, to make a determination with respect to any claimed antitrust immunity. Here no facts are in dispute or need to be developed regarding the question of implied repeal, and therefore *Ricci* is inapposite.

The decision of the Court below* is also consistent with other decisions by this Court holding that where the conduct at issue in an antitrust case constitutes the basic ingredient of an agency's regulatory authority, a plaintiff must rely upon the administrative remedies provided by the Congress rather than on the antitrust laws. *Hughes Tool Co.* v. *Trans World Airlines, Inc.,* 409 U.S. 363 (1973); *Pan American Airways* v. *United States,* 371 U.S. 296 (1963); *United States Navigation Co.* v. *Cunard S. S. Co.,* 284 U.S. 474 (1932).

In *Cunard* this Court said:

> "A comparison of the enumeration of wrongs charged in the bill with the provisions of the sections of the Shipping Act above outlined conclusively shows, without going into detail, that the allegations either constitute direct and basic charges of violations of these provisions or are so interrelated with such charges as to be in effect a component part of them; and the remedy is that afforded by the Shipping Act, which to that extent supersedes the antitrust laws." 284 U.S. at 485.

In *Pan American* this Court observed:

> "The acts charged in this civil suit as antitrust violations are precise ingredients of the Board's authority in granting, qualifying, or denying certificates to air carriers, in modifying, suspending, or revoking

* The decision was followed in Abbott Securities Corp. v. New York Stock Exchange, 5 CCH Trade Reg. Rep. 1974-2 Trade Cas. ¶ 75,324 (D.D.C., Oct. 30, 1974) at p. 98,029.

them, and in allowing or disallowing affiliations between common carriers and air carriers." 371 U.S. at 305.

Pointing out that the Congress had created a regulatory regime under a special "public interest" standard and entrusted the CAB, not the courts, with the enforcement of that standard, the Court concluded that antitrust repeal was necessitated by the regulatory statute because "[i]f the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide." 371 U.S. at 310.

The principle of *Pan American* was reiterated and applied in *Hughes,* in which this Court said:

". . . In this context, the authority of the Board to grant the power to 'control' and to investigate and alter the manner in which that 'control' is exercised leads us to conclude that this phase of CAB jurisdiction, like the one in the *Pan American* case, pre-empts the antitrust field." 409 U.S. at 385 (footnote omitted).*

The Solicitor General suggests (S.G. Br., p. 48) that even if there is a prospective conflict between the SEC and the courts, this Court can circumvent that problem by recognizing in the decree the SEC's power to order exchanges to engage in conduct prohibited by the decree, citing *Otter*

* Plaintiff (as did the *Thill* Court) relies on United States v. Philadelphia National Bank, 374 U.S. 321 (1963) (P. Br., p. 7). But as the Court below noted, there are significant differences between that case and this one. (A-451, n.11). In *Philadelphia National Bank* this Court found no conflict between the Bank Merger Act and the Clayton Act. It also found that the legislative history of the Bank Merger Act evidenced a Congressional intent to have the antitrust laws continue to apply to bank mergers (374 U.S. at 352). A further distinction is that here Congress has granted the SEC continuing oversight jurisdiction over the conduct challenged (*see* FMC *v. Seatrain Lines, Inc.,* 411 U.S. 726, 732 (1973)), while the Bank Merger Act vested no such authority in the Comptroller of the Currency.

Tail Power Co. v. *United States,* 410 U.S. 366 (1973). But by suggesting that the SEC has the final say with respect to rate-fixing by exchanges the Solicitor General in effect concedes that the SEC has exclusive jurisdiction in this area and that the courts have no useful role to play.

B. A Finding of *Pro Tanto* Implied Repeal Requires no Pervasive Regulatory Scheme.

It is also argued (S.G.Br., pp. 9, 16, 35, 37) that a repeal of the antitrust laws should not be implied in this case because the Exchange Act allegedly does not create a pervasive, comprehensive, "public utility-like" regulatory scheme. This principle has no application since no claim is made that the regulatory scheme at issue is so all-encompassing as to leave no room for application of the antitrust laws, although it could be argued that the scope of Section 19(b) is so "comprehensive" as to cover virtually all aspects of an exchange's rules, and the SEC has so interpreted it. SEC Release No. 9950, January 16, 1973, 38 Fed. Reg. 3902; SEC Exchange Act Release No. 11203, *supra,* at 4-5.

It is defendants' position that a repeal of the Sherman Act must be implied *pro tanto* to give effect to the Congressional intent evidenced in Section 19(b)(9) to permit SEC-supervised exchange rate-fixing. This requires no "pervasive" scheme. As this Court explained in its *Hughes* decision, a regulatory scheme not sufficient to grant a blanket exemption from the antitrust laws may, nevertheless, do so in particular and discrete instances. 409 U.S. at 592, n. 14. Numerous regulatory statutes have been held to confer exclusive jurisdiction on an agency over some matters, while denying exclusivity to the agency in regard to matters which are amenable to complementary forms of

regulation, such as the antitrust laws.* Compare, *e.g.*, *Keogh* v. *Chicago & Northwestern Ry.*, 260 U.S. 156 (1922), and *FCC* v. *RCA Communications, Inc.*, 346 U.S. 86 (1952) with *Georgia* v. *Pennsylvania R.R. Co.*, 324 U.S. 439 (1945) and *United States* v. *Radio Corp. of America*, 358 U.S. 334 (1959). In none of those cases did this Court lay down the rule that implied repeal of the Sherman Act required "public utility-like" regulation.**

The Solicitor General argues that no adequate record was made below and that summary judgment was therefore inappropriate (S.G. Br., p. 26). However, a factual record concerning "necessity" or the adequacy of the exercise of SEC review power is not the touchstone of implied repeal. In *Silver*, too, summary judgment had been granted and this Court did not suggest that this was inappropriate in a case involving implied repeal of the antitrust laws.

It is also argued, citing *Thill*, that the mere existence of review power in the SEC is insufficient to support a determination of implied repeal (S. G. Br., p. 25). However, even if the *Thill* interpretation of this Court's *Silver* opinion were correct—that the existence of SEC review jurisdiction is not by itself sufficient for implied repeal but a trial must be held to determine whether the SEC has actively and adequately exercised that jurisdiction—that test is more than adequately met by the ample and undisputed evidence in the record. That evidence shows that the SEC for over a decade has been diligently exercising its review jurisdiction through public hearings in which the Antitrust Division participated, and through investigations, studies and communications with the exchanges with respect to numerous aspects of the level and structure of commission

* The Solicitor General argues (S.G.Br., p. 45) that the antitrust laws supplement, rather than conflict with, the Exchange Act in the same way as private enforcement of the SEC's proxy rules supplement SEC action. However, it is clear that in the latter case dual enforcement is for the purpose of securing compliance with the same standards of conduct, while here the antitrust laws and Section 19(b)(9) of the Exchange Act prescribe contradictory standards of conduct.

** As the SEC has pointed out, there are numerous and important differences between regulation in the securities industry and traditional public utility regulation. Special Study Pt. 2, pp. 328-29.

rates. (A-45-52; 98-215; 221-228; 294-417) The result has been a continuous series of significant changes in the fixed commission system ordered or approved by the SEC, including the introduction of competitive rates first above the $500,000 level, then above the $300,000 level, and then at or below the $2,000 level, all under the SEC's deliberate policy of prudent gradualism. These steps, after monitoring of their effects, have now culminated in an SEC rule requiring the complete abolition of fixed rates by May 1 of this year subject to possible reinstitution of some form of fixed rates in the future. SEC Exchange Act Release No. 11203, *supra*.

The Solicitor General, however, apparently considers anything less than a formal order by the SEC to be insufficient to result in implied repeal, although conceding that if there were such an order "no antitrust liability could arise." (S.G. Br., p. 48). But Section 19(b) does not contemplate direct SEC regulation by formal order but contemplates, instead, a system of exchange self-regulation with power in the SEC to request changes in exchange rules only if necessary or appropriate to comply with the statutory standards. See *Silver* v. *New York Stock Exchange, supra*, at 352-55. If no change is deemed necessary, there is nothing for the SEC to do, and the exchange rules are permitted to stand. No express approval is required. *Exchange Buffet Corp.* v. *New York Stock Exchange*, 244 F.2d 507, 510 (2d Cir. 1957). Even if a change is necessary the SEC must first request such change and only proceed by rule or order if an exchange refuses to comply with the request.

Thus, while it is true that no formal order has been entered by the SEC with respect to exchange rules fixing commission rates, it is equally clear from the record that every step taken by the exchanges with respect to commission rates since 1968 has been at the express direction or request of the SEC as contemplated by Section 19(b) of the Exchange Act. Under these circumstances, by reason of the exchanges' voluntary compliance, a formal order would be

superfluous. It would hardly serve the objectives of cooperative SEC-exchange regulation established by the Exchange Act to require the exchanges to refuse, in every case, to accede to the SEC's 19(b) requests and to require the SEC to direct changes in exchange rules by formal order so that the exchanges could be free from antitrust attack.

If the Solicitor General's position were to be upheld, in the absence of a formal SEC order exchange self-regulation would necessarily be subjected to dual, and possibly conflicting, regulation by the SEC and the courts, since every rule or practice of an exchange, even after thorough review and express approval or modification by the SEC, would be subject to a *de novo* review by a court or a jury in a collateral antitrust action. Such a result would clearly chill self-regulation by exchanges, thereby frustrating the objectives of the Exchange Act.

As observed by the District Court in *Kaplan:*

> "To subject the Exchange to the perils of treble liability, retroactively imposed, upon the variant decisions of different courts in determining the reasonableness of rates would inevitably disrupt the congressional plan designed to bring order to the marketing of securities." 250 F. Supp. at 566.

III.

Plaintiff has a non-antitrust remedy and forum.

As recently held by the Seventh Circuit, "Private parties may only bring antitrust claims against an exchange or its members when there is no other vehicle for review." *Schaefer* v. *First National Bank of Lincolnwood, supra.*

Plaintiff claims, however, that unless collateral antitrust review is permitted, SEC action with respect to exchange rules fixing commission rates can never be subject to independent judicial scrutiny. (P. Br., pp. 5-7). He relies, in part, on two unreported decisions, each of which was rendered without opinion. *Independent Investor Protective League* ["*IIPL*"] v. *SEC,* Dkt. No. 71-1924 (2d Cir., *dism'd without opinion,* Nov. 15, 1971); *IIPL* v. *SEC,* Dkt. No. 71-1984 (D.D.C., *filed,* Oct. 1, 1971, *dism'd without opinion,* June 19, 1972). The grounds for dismissal of those actions not having been disclosed, it cannot be said that the decisions stand for any discernible proposition of law.

In any case, it is clear that plaintiff has a right to obtain review of the SEC's exercise of its Section 19(b) jurisdiction under the Administrative Procedure Act, 5 U.S.C. §§ 500, 551 *et seq.* (the "APA"). Section 6(a) of the APA authorizes any "interested person" to appear before an agency to present his views. 5 U.S.C. § 555(b). In addition, Section 4(d) permits such a person to petition an administrative agency for the issuance, amendment or repeal of any "rule," defined by Section 2(c) to include the "approval or prescription for the future of rates." 5 U.S.C. §§ 553(e), 551(4). Section 10 provides for district court review of any administrative action, broadly defined by Section 2(g) to include any form of action or failure to act. 5 U.S.C. §§ 702, 551(13).

In arguing (S.G. Br., p. 28) that there is no procedure under the Exchange Act to challenge exchange rules, the Solicitor General overlooks the APA and *Independent Investor Protective League* v. *New York Stock Exchange,* 367 F.Supp. 1376 (S.D.N.Y. 1973), where the Court said:

> "If plaintiff wishes to influence or change Exchange policy [or rules], his remedy is to petition the SEC to exercise its powers under § 19(b) of the [Exchange] Act to recommend changes in Exchange rules, or to alter or amend the rules. The Administrative Procedure Act, § 4(d), 5 U.S.C. § 553(e) provides that '[e]ach agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.' If plaintiff is 'aggrieved' by SEC action [or

inaction] relating to Exchange rules, the APA § 10, 5 U.S.C. § 702 gives him the opportunity for judicial review." 367 F.Supp. at 1377.

Finally, the Solicitor General alludes to the SEC's earlier unsuccessful denial that its "19(b) letters" to exchanges requesting changes in their rules constitute "agency action". (S.G. Br., pp. 39-41). But the SEC's former position has been judicially rejected in *Independent Broker-Dealers' Trade Association* v. *SEC*, 442 F.2d 132, 143 (D.C. Cir.), *cert. denied*, 404 U.S. 828 (1971), and its present position is to the contrary. (See SEC brief as *amicus curiae* filed with this Court).

CONCLUSION

As Mr. Justice Stewart noted in dissenting with Mr. Justice Harlan from the majority opinion in *Silver:*

> "The purpose of the self-regulation provisions of the Securities Exchange Act was to delegate governmental power to working institutions which would undertake, at their own initiative, to enforce compliance with ethical as well as legal standards in a complex and changing industry. This self-initiating process of regulation can work effectively only if the process itself is allowed to operate free from a constant threat of antitrust penalties. To achieve this end, I believe it must be held that the Securities Exchange Act removes antitrust liability for any action taken in good faith to effectuate an exchange's statutory duty of self-regulation." 373 U.S. at 371.

The Court below correctly determined that the Congress, in enacting Section 19(b)(9) of the Exchange Act, intended to repeal, by implication, the Sherman Act to the extent that

the latter statute would otherwise prohibit commission rate-fixing by exchanges, subject to SEC oversight and revision powers.

Accordingly, this Court should affirm the decision below.

February 19, 1975

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In the Supreme Court of the United States

OCTOBER TERM, 1974

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-304

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 35–51) is reported at 498 F.2d 1303. The opinion of the district court (Pet. App. 21–34) is reported at 366 F. Supp. 1261.

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1974. The petition for a writ of certiorari was filed on September 19, 1974, and was granted on November 18, 1974. The jurisdiction of this Court rests on 28 U.S.C. 1254(1). *Silver* v. *New York Stock*

Exchange, 373 U.S. 341; *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289.

QUESTION PRESENTED

Section 6(b) and (d) of the Securities Exchange Act of 1934 imposes a duty of self-regulation upon registered securities exchanges by requiring them to adopt rules to enforce just and equitable principles of trade, to insure fair dealing and to protect investors. Section 19(b) of the Act empowers the Securities and Exchange Commission to require changes in such rules where necessary or appropriate for the protection of investors, to assure fair dealing in securities transactions, or to insure fair administration of the exchange. Section 19(b)(9) includes, among the matters subject to this power, "the fixing of reasonable rates of commission, interest, listing, and other charges."

The question the United States will discuss is whether these provisions, on their face, repeal by implication the otherwise applicable antitrust laws; or whether such repeal exists only insofar as a court finds that particular instances of price fixing are necessary, but no more restrictive than necessary, to make the scheme of the Securities Exchange Act work.

STATUTES INVOLVED

The pertinent provisions of the Sherman Act, the Clayton Act, and the Securities Exchange Act of 1934, are set forth in the appendix *infra,* pp. 57–72.

INTEREST OF THE UNITED STATES

The United States, through the Attorney General and the Department of Justice, has primary responsibility for enforcing the Sherman Act, 15 U.S.C. 1, *et seq.,* which expresses the nation's fundamental economic policy in favor of free competition. This case raises an important question concerning the application of that Act to collective price fixing by members of the nation's securities exchanges. These exchanges are the principal marketplaces for investors in the private enterprise system. Upon their functioning as efficient, liquid markets depends, in significant part, the ability of private enterprise to raise capital. This vital function led Congress in 1934 to declare that securities exchanges "are affected with a national public interest." Section 2, Securities Exchange Act of 1934, as amended, 48 Stat. 881, 15 U.S.C. 78b.

Studies of the securities industry in the last decade have raised serious questions whether the exchanges' practice of setting fixed commission rates by agreement among members who execute transactions for investors and non-member brokers, should be tolerated as an exception to the policy of competition enforced in all other sectors of the economy. It has been contended in antitrust courts, proceedings before the Securities and Exchange Commission ("SEC"), and in testimony before Congress, that fixed commission rates subsidize inefficiency, fragment market trading, promote evasion of the price fixing scheme by large institutional investors and others with economic lever-

age, impose substantial and unnecessary costs on the investing public, and thereby discourage investment in securities traded on the exchanges to the detriment of the effectiveness and liquidity of those markets. If the Sherman Act does not apply to such market places, located as they are at the heart of our system of private capitalism, it can only be because Congress has consciously made such a decision. We do not find in the language, structure or history of the 1934 Act, or in the assumptions of the court of appeals concerning the wisdom of fixed commission rates, any basis for concluding that the 1934 Act, on its face, rendered the antitrust laws inapplicable to exchange price-fixing.

This Court's decision in this case will have a significant impact upon the application of the antitrust laws to the securities industry, and on the method for determining their application to other regulated industries as well. The United States, therefore, is vitally concerned with the way this Court decides the issue.

STATEMENT

Petitioner Gordon filed a complaint in the United States District Court for the Southern District of New York in January 1971, on behalf of himself, the Independent Investors Protective League, and an alleged class of "small investors" who purchase stocks listed on the New York Stock Exchange and the American Stock Exchange in amounts of less than $500,000 per purchase. (App. A–8).[1] Both exchanges

[1] "App." refers to the Appendix filed by petitioner.

were named as defendants. Merrill Lynch, Pierce, Fenner & Smith, Inc. and Bache & Co. were also named as defendants, both individually and as representatives of an alleged class composed of members of the New York and American Stock Exchanges. The complaint alleged that the respondents are violating Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1, 2, and the Robinson-Patman Act, 15 U.S.C. 13; and prayed for treble damages and injunctive relief.

A. THE DISTRICT COURT'S DECISION

The district court granted the respondents' motion for summary judgment on December 3, 1973, without determining whether the plaintiff or defendant classes are properly constituted (Pet. App. 34). That court construed the complaint as alleging "claims regarding the Exchanges' practice of limiting the number of memberships, and denying the use of their facilities to nonmembers unless they pay the same rate of commission charged the general public" (Pet. App. 23), that the respondents violated the Robinson-Patman Act by adopting discriminatory commission rates (Pet. App. 24), and that they violated the Sherman Act by fixing commission rates (Pet. App. 25).

The district court concluded that petitioner lacks standing to challenge the memberships limitation because he is not an injured person, that the fee preference for exchange members is authorized by Section 3(a)(3) of the Securities Exchange Act, 15 U.S.C. 78c(a)(3), and that the Robinson-Patman Act is not applicable to discrimination in the pricing of broker-

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age services (Pet. App. 23–24). The court of appeals characterized these claims as "frivolous" (Pet. App. 38) and they were not discussed in the petition for a writ of certiorari.[2] Accordingly, the proceeding in this Court involves only the dismissal of the complaint insofar as it alleges that the respondents have violated the Sherman Act by fixing the commission rates for stock transactions on the exchanges, seeks to recover damages for such rate-fixing, and seeks to enjoin the respondents from fixing such commission rates in the future.

The respondents did not deny that both exchanges have adopted rules establishing minimum commission rates for stock transactions on the exchanges. The district court held that it "lacks jurisdiction to entertain an antitrust attack on the commission structure of the Exchanges" because Section 19(b)(9) of the Securities Exchange Act "expressly directs the SEC to supervise the 'fixing of reasonable rates of commission' * * *" (Pet. App. 26).

B. THE COURT OF APPEALS' DECISION

The Court of Appeals for the Second Circuit affirmed the dismissal of petitioner's price-fixing claim. It noted that this Court had examined the application of the antitrust laws to securities exchanges in *Silver* v. *New York Stock Exchange,* 373 U.S. 341, and had declared that repeal of the antitrust laws "is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." *Id.* at 357 (Pet.

[2] The petition does not set forth the "Questions Presented". Therefore, the questions must be inferred from its text.

App. 39). The court said, however, that this case "'* * * is *toto cuelo* different from *Silver* * * *'" (Pet. App. 39). It noted that Section 19(b)(9) expressly vests oversight of the fixing of rates of commission in the SEC; that Congress considered SEC-supervised exchange self-regulation to be an essential element in the scheme of the 1934 Act; and that the Act "explicitly provides for 'the *fixing* of reasonable rates of commission,'" despite this Court's holding seven years earlier in *United States* v. *Trenton Potteries Co.,* 273 U.S. 392, that price fixing is a *per se* violation of the Sherman Act (Pet. App. 42–43). The court declared that "[i]f the discussion in *Silver* of a core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws, is to be given any meaningful application, we are of the view that it must have reference to the practices enumerated in § 19(b), and in this instance to the fixing of reasonable rates of commission" (Pet. App. 41). The court thus concluded that Section 19(b) vested exclusive jurisdiction over exchange rate fixing in the SEC.

It also stated that its conclusion was supported by sound policy. It expressed fear that the courts and the SEC might subject exchanges to "repetitive or conflicting standards," a hazard which it found to be confirmed by the "wide-reaching and systematic character of recent SEC action regarding rate regulation" (Pet. App. 44). In its view, although no record had been developed in the district court, there was "little question but that the commission rate structure is the keystone of the economic viability of the brokerage industry, and a matter of vital import-

ance to individnal investors as well" (Pet. App. 44). It considered the SEC alone expert enough to reduce "the barriers to investor trading, while at the same time assuring a return sufficient to preserve brokerage capacity * * *" (*ibid.*). For, the court found, "[s]uch questions as the effect of fixed commission rates on trading volume and broker solvency, or the effect of competition on and the necessity for exchange membership, are not of the sort which courts can answer as well as the SEC" (Pet. App. 49).

The court expressly disagreed (Pet. App. 49–50) with *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (C.A. 7), certiorari denied, 401 U.S. 994, which had reversed dismissal of a similar complaint and remanded it for a full trial under the criteria of the *Silver* decision.

SUMMARY OF ARGUMENT

Apart from any immunity provided by the Securities Exchange Act of 1934, the collective fixing of commission rates for brokerage services by members of the nation's securities exchanges is a *per se* violation of the Sherman Act. The 1934 Act contains no express exemption from the antitrust laws; its provisions are in addition to other remedies at law or in equity. 15 U.S.C. 78bb. *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 357, held that repeal of the antitrust laws is "implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." This decision reflected the long line of authorities holding that regulation of aspects of an industry does not, of itself, oust antitrust jurisdiction.

In the *Silver* case the Securities and Exchange Commission (SEC) did not have specific authority to review the practices involved, although the Court assumed that it could have required the exchanges to adopt rules establishing fair procedures for dealing with those practices. In *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289, 302, n. 13, this Court ruled that self-regulatory conduct, arguably within the supervisory authority of the Commodity Exchange Commission under a statute closely similar to the Securities Exchange Act, was not for this reason immune from the Sherman Act. Rather, it held, the ultimate responsibility for deciding whether the defense of necessity under the regulatory act has been established is vested in the antitrust courts. The record in this case, made on defendants' motion for summary judgment, is inadequate for determining this issue.

The language, structure and history of the 1934 Act disclose a purpose to place primary responsibility for self regulation through internal rules on the exchanges, subject to a reserved oversight by the SEC under Section 19(b). The Act thus does not create a pervasive regulatory scheme which substitutes public utility type regulation for competition, and the SEC has never claimed power to exercise such regulation. On the contrary, the availability of antitrust remedies supplements the regulatory scheme; competition makes more detailed regulation unnecessary. There is no danger of duplicative or inconsistent requirements arising from antitrust jurisdiction; the SEC itself has directed abolition of fixed commission rates.

ARGUMENT

THE SECURITIES EXCHANGE ACT OF 1934 DOES NOT EXEMPT FROM THE SHERMAN ACT THE FIXING OF COMMISSION RATES BY REGISTERED SECURITIES EXCHANGES, EXCEPT TO THE EXTENT THAT A COURT DETERMINES THAT SUCH EXEMPTION IS NECESSARY TO MAKE THE SECURITIES EXCHANGE ACT WORK

The position of the United States is that exchange rules embodying agreements fixing commission rates for brokerage services by members of securities exchanges are subject to scrutiny by antitrust courts under the Sherman Act, even though the SEC may also examine such rules under Section 19(b) of the Securities Exchange Act of 1934. Such rules are price-fixing agreements, and are exempted from the antitrust laws by the 1934 Act, only if, and to the minimum degree, necessary to make that Act work. The 1934 Act thus may create a defense analogous to the defense that an otherwise prohibited restraint is lawful because ancillary, and essential, to a legitimate joint venture. If the agreement fixing minimum commission rates is not necessary to effectuate the aims and purposes of the 1934 Act, the Sherman Act prohibits it.

Section 19(b) of the Securities Exchange Act gives the SEC supervisory authority over "the fixing of reasonable rates of commission" by securities exchanges, but not authority to decide whether the fixing of rates itself is exempt from the antitrust laws. The latter determination, which depends upon whether such rate fixing is necessary to make the 1934 Act work, must be made by an antitrust court.

This record is not adequate to permit a decision whether the latter determination requires invocation of the SEC's primary jurisdiction. Our submission is simply that the SEC does not have exclusive jurisdiction over that determination.

A. THE FIXING OF STANDARD RATES OF COMMISSION BY SECURITIES EXCHANGES IS ILLEGAL *PER SE* UNLESS JUSTIFIED BY THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT AS DETERMINED BY THE ANTITRUST COURTS

A securities exchange is a voluntary, private organization of individuals who deal in securities; it provides a market place or facilities for bringing together the purchasers and sellers of securities (15 U.S.C. 78c(a)(1)). The collective activities of exchange members affecting competition are subject to the antitrust laws, except to the extent Congress has otherwise provided. *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 348, n. 5; *Associated Press* v. *United States,* 326 U.S. 1; *United States* v. *Terminal R. Ass'n of St. Louis,* 224 U.S. 383. Apart from any immunity provided by the Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq.,* the collective fixing of commission rates for brokerage services is a *per se* violation of the Sherman Act. *United States* v. *National Ass'n of Real Estate Boards,* 339, U.S. 485, 488–489; *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 212–228; *United States* v. *Trenton Potteries Co.,* 273 U.S. 392.

Even in highly regulated industries, rate-fixing combinations not specifically authorized by law are *per se* violations; this is true even though the rates themselves have been approved, as reasonable, by a regulatory agency. *Georgia* v. *Pennsylvania R. Co.,* 324

U.S. 439, 457–459; *Keogh* v. *Chicago & N.W. Ry. Co.*, 260 U.S. 156, 161–162; *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290; *United States* v. *Joint Traffic Association*, 171 U.S. 505. And even where the law provides that rate-fixing agreements approved by an agency are exempt from the antitrust laws, when such agreements are implemented without such approval, they violate those laws. *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213.

The Securities Exchange Act of 1934 ("the 1934 Act") contains no express provision empowering the SEC to grant immunity from the antitrust laws for rate-fixing combinations. It provides in Section 6(b) and (d) (15 U.S.C. 78f(b), (d)) for a system of self-regulation by exchanges, to be exercised through the private initiative of their members, subject to certain regulatory powers vested in the SEC. Any group of competing sellers, of course, may combine for the advancement of mutual interests so long as their activities are not in restraint of trade.[3] When such competitors are by statute required to engage in self-regulation, the requirement may result in collective actions which would otherwise violate the Sherman Act. In the absence of express immunity, however, "[o]nly a clear repugnancy between the old law and the new results in the former giving way and then only *pro tanto* to the extent of the repugnancy," *Georgia* v. *Pennsylvania R. Co., supra*, 324 U.S. at 457.

In *Silver* v. *New York Stock Exchange, supra*, 373 U.S. at 357, this Court held that the system of self-

[3] Compare *Maple Flooring Mfrs. Ass'n* v. *United States* 268 U.S. 563, with *Sugar Institute* v. *United States*, 297 U.S. 553.

regulation prescribed by the 1934 Act, and the national policy of competition expressed in the antitrust laws, were to be analyzed in a way "which reconciles the operation of both statutory schemes with one another rather than holding one completely ousted." Accord, *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware*, 414 U.S. 117, 127. Noting that the Securities Exchange Act contains no express exemption from the antitrust or other laws, and that any repeal of the antitrust laws would therefore depend on implication from the regulatory scheme, the Court ruled (373 U.S. at 357):

> Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes.

The court of appeals held this "guiding principle" inapplicable because Section 19(b)(9) of the Securities Exchange Act gives the SEC jurisdiction to modify exchange rules relating to the fixing of commissions. In its view, this jurisdiction is neither concurrent nor primary; it is exclusive, and thus completely ousts the antitrust laws with respect to any of the matters enumerated in Section 19(b).

The issue before this Court is not whether rate fixing by the nation's private securities exchanges is essential, under *Silver*, to the scheme of the Securities Exchange Act. It is how courts are to decide whether the antitrust laws have been repealed insofar as they would otherwise apply to commission rates collectively established in the rules of securities exchanges.

The analysis by the courts below departs from a

long line of this Court's decisions holding that repeal of the antitrust laws by implication from a regulatory scheme is strongly disfavored, and refusing to find such a repeal necessary.[4]

Silver held that the duty of self-regulation imposed on exchanges by the Securities Exchange Act did not, of itself, exempt such activities from the antitrust laws. It recognized, however, that self-regulatory activities within the general purview of the Act's requirements may give rise to an exemption from the antitrust laws. Even though "the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws, * * * it is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." 373 U.S. at 360–361. Arguably, even claims involving conduct which otherwise is a *per se* violation of the Sherman Act may be justified under this standard.

It was unnecessary for the Court in *Silver* to consider the effect of SEC review of the specific prac-

[4] See *e.g.*, *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 372–375; *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, 302, n. 13; *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213, 217–218; *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 350–351; *Silver* v. *New York Stock Exchange*, *supra*, 373 U.S. at 357–358; *California* v. *Federal Power Commission*, 369 U.S. 482, 489; *United States* v. *Radio Corp. of America*, 358 U.S. 334; *United States* v. *Borden Co.*, 308 U.S. 188, 198; *United States* v. *Pacific and Artic Ry. and Nav. Co.*, 228 U.S. 87, 105, 107; *United States* v. *Joint Traffic Association*, 171 U.S. 505; *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290, 314–315; *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439, 456–547.

tices there involved because the statute did not provide for it. Subsequently, however, in *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, the Court reached that issue. *Ricci* involved a system of self-regulation, closely similar to the scheme for the securities industry, imposed on commodity exchanges by the Commodity Exchange Act, 7 U.S.C. 1, *et seq.* This Court ruled that self-regulatory conduct, arguably within the supervisory authority of the Commodity Exchange Commission, was not, for this reason, immune from the Sherman Act (409 U.S. at 302, n. 13), and that the test of *Silver* requires a full examination by the antitrust court, of the defense of necessity under the regulatory act. See, also, *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F. 2d 264 (C.A. 7), certiorari denied, 401 U.S. 994, appeal dismissed after remand, 469 F. 2d 14; *Harwell* v. *Growth Programs, Inc.*, 451 F. 2d 240 (C.A. 5), rehearing denied, 459 F. 2d 461, certiorari denied *sub nom. National Ass'n of Securities Dealers, Inc.* v. *Harwell*, 409 U.S. 876; *Zuckerman* v. *Yount*, 362 F. Supp. 858 (N.D. Ill.); *Fredrickson* v. *Merrill Lynch, Pierce, Fenner & Smith*, 1974–2 Trade Cases, ¶ 75,227 (N.D. Ill., decided September 9, 1974), appeal pending, C.A. 7; but cf. *Abbott Securities Corp.* v. *New York Stock Exchange*, 1974–2 Trade Cases, ¶ 75,324 (D.C.D.C., decided October 30, 1974). For the purposes of this examination it may be appropriate or even necessary that particular issues be referred to the regulatory agencies under the primary jurisdiction doctrine (see *Ricci, supra*), or the agency may participate in the court proceeding as an *amicus* or intervenor. But resolution of the manner of agency participation is for the trial court in the

first instance. See *Thill Securities Corp.* v. *New York Stock Exchange, supra.*

Only if the Securities Exchange Act contained a pervasive scheme of regulation, reflecting a deliberate legislative decision to substitute detailed governmental supervision for private initiative and free competition, could it be concluded that the regulatory powers reserved to the SEC under the Act completely oust the antitrust laws. Compare *Pan American World Airways* v. *United States,* 371 U.S. 296, with *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 351–352; *California* v. *Federal Power Commission, supra,* and *Otter Tail Power Co.* v. *United States, supra.* As we show, *infra,* pp. 26–35, the 1934 Exchange Act does not establish such a scheme. Far from imposing public utility type regulation on the exchanges, the Act was designed to assure that securities exchanges operate under a regime of free enterprise, subject only to a duty of self-regulation to protect investors, and the enumerated powers of the SEC to eliminate practices contrary to the public interest.

Indeed, the Act does not provide for SEC approval of exchange rate-fixing rules at all.[4] Such rules may be promulgated entirely at the exchange's private discretion. Cf. *American Telephone & Telegraph Co.* v. *Federal Communications Commission,* 487 F. 2d 865

[4] Although the 1934 Act does not provide for advance approval by SEC of exchange rules, SEC can, and has since 1964, required that it be notified in advance of proposed changes in such rules, so that it may scrutinize them. 29 Fed. Reg. 3471, 17 C.F.R. 240.17a–8. Cf. *American Telephone and Telegraph Co.* v. *Federal Communications Commission,* 503 F. 2d 612 (C.A. 2).

(C.A. 2). In such circumstances, a general repeal of the antitrust laws, leaving exclusive jurisdiction over price-fixing in the regulatory agency, cannot be inferred. *Carnation Co.* v. *Pacific Westbound Conference, supra.* The full examination contemplated by *Silver* is required.

The record in this case, made on defendants' motion for summary judgment, is inadequate for this purpose. purpose.

B. UNDER RICCI V. CHICAGO MERCANTILE EXCHANGE, 409 U.S. 289, A FULL RECORD SHOULD HAVE BEEN DEVELOPED FOR APPLICATION OF THE SILVER TEST.

Insofar as the court of appeals purported to distinguish *Silver* on the ground that the conduct challenged there was not subject to SEC oversight, it erred. The *Ricci* case makes clear that the *Silver* test applies even where self-regulatory conduct is within the scope of regulatory jurisdiction, that the antitrust court has the responsibility for applying that test, and that a full evidentiary record is needed.

1. The Silver case

Silver was an antitrust suit against the New York Stock Exchange (NYSE) by a non-member and his broker-dealer firms. He alleged that he had been injured by an illegal boycott, a *per se* Sherman Act violation, because his wire communications with exchange members had been terminated without notice or hearing. The members had terminated Silver at the direction of the NYSE, which acted under exchange rules adopted pursuant to the self-regulatory provisions of the Act. The district court ruled that the NYSE's statutory duty of self-regulation did not extend to

members' relations with non-members handling over-the-counter securities.[8]

The Second Circuit reversed (302 F. 2d 714). After reviewing the structure of the Act, the court concluded that it gave the SEC and the NYSE disciplinary powers over exchange members with regard to over-the-counter securities; that the Exchange was required to exercise these powers as part of its duty of self-regulation; and that application of the Sherman Act to particular decisions under this duty would defeat the statutory policy of self-regulation. The court of appeals explained that "[i]f securities exchanges were in constant danger of subjecting themselves to liability under the anti-trust laws for any misapplication of their disciplinary powers, they would understandably be reluctant to fulfill their obligations under the Securities Exchange Act." *Id.* at 720–721. The Second Circuit's decision in the instant case closely parallels that reasoning.

This Court reversed. 373 U.S. 341. It noted that the Securities Exchange Act "does not give the Commission jurisdiction to review particular instances of enforcement of exchange rules." *Id.* at 357. This made it unnecessary to consider whether the primary jurisdiction doctrine was applicable. Moreover, the Court continued, "the Commission's lack of jurisdiction over particular applications of exchange rules means that the question of antitrust exemption does not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power." *Id.* at 358. Had

[8] *Silver* v. *New York Stock Exchange*, 196 F. Supp. 209 (S.D.N.Y.).

such jurisdiction existed, the Court noted, "a different case would arise * * *." *Id.* at 358, n. 12.

Analyzing the case to determine whether the duty of self-regulation imposed by the Act was incompatible with the antitrust laws, the Court concluded that "[t]he entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act." *Id.* at 360. It rejected the district court's conclusion that the Act did not cover exchange members' relations with over-the-counter traders. 373 U.S. at 355–356. More significantly, however, the Court rejected the Second Circuit's holding that the Exchange's general duty of self-regulation, and the risk that antitrust liability might chill its performance, compelled the conclusion that the Act had repealed the antitrust laws.

Applying the test of necessity set forth above, pp. 12–13, *supra*, the Court concluded that no justification existed for termination of vital wire connections without notice or opportunity for hearing. No policy contained in the Securities Exchange Act was served by such conduct; on the contrary, it was inconsistent with the purpose of the self-regulatory scheme to protect investors and promote fair dealing.

The Court specifically assumed that the SEC, pursuant to its powers under Section 19(b), could adopt a general rule providing for notice and hearing. It recognized that the exchange rule involved was, to that extent, within the reserved supervisory jurisdic-

tion of the SEC. 373 U.S. at 304, n. 16.[6] It noted, moreover, that such a rule would have to provide for notice and hearing to be compatible with the antitrust laws. *Ibid.* Nevertheless, absent Commission adoption of such a rule of fair procedure, and given the Court's finding that such procedure is compatible with both antitrust and securities regulation principles, it concluded that under the necessity test the ecurities Exchange Act did not oust the antitrust laws as applied to the conduct involved, and that an antitrust court could announce the rule.

2. The Ricci case

The Court in *Silver* had reserved any question concerning primary or concurrent jurisdiction by the antitrust courts and the regulatory agencies, because the SEC did not have authority to review specific instances of enforcement of exchange rules. In *Ricci* v. *Chicago Mercantile Exchange, supra,* the Court considered this "different" case. The plaintiff in that case alleged a conspiracy under the Sherman Act to exclude him from membership on the Chicago Mercantile Exchange, a designated contract market under the Commodity Exchange Act, 42 Stat. 998, as amended 7 U.S.C. 1, *et seq.* The district court dismissed the complaint. The court of appeals reversed the dismissal, but concluded that the challenged conduct was within the regulatory jurisdiction of the Secretary of Agriculture or the Commodity Exchange Commission under the Commodity Exchange Act. It therefore remanded the case with instructions that proceedings be stayed pending a submission of the matter to these authorities. 447 F. 2d 713 (C.A. 7).

The Commodity Exchange Act is closely similar to the Securities Exchange Act.[7] This Court reviewed the claims involved in the light of the *Silver* case. Since the complaint alleged that the challenged conduct violated the regulatory statute as well as the Sherman Act, the Court held that administrative authority over the dispute between the plaintiff and the exchange was sufficient to justify staying the case until the administrative officials could act on the Commodity Exchange Act issues.

The Court rejected any suggestion that the Com-

[6] "It may be assumed that the Securities and Exchange Commission would have had the power, under § 19(b) of the Exchange Act, 15 U.S.C. § 78s(b), pp. 352–353 357 & note 7, *supra*, to direct the Exchange to adopt a general rule providing a hearing and attendant procedures to nonmenbers. However, any rule that might be adopted by the Commission would, to be consonant with the antitrust laws, have to provide as a minimum the procedural safeguards which those laws make imperative in cases like this. Absent Commission adoption of a rule requiring fair procedure, and in light of both the utility of such a rule as an antitrust matter and its conpatibility with securities-regulation principles (see p. 361, *supra*), no incompatibility with the Commission's power inheres in announcement by an antitrust court of the rule. Compare *Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 723–724."

[7] It requires that all commodity futures be traded on contract markets as designated by the Secretary. Like securities exchanges, these markets are under a duty of self-regulation and are required to file their by-laws, rules and regulations with the Secretary. He may disapprove them, much as the SEC can object to or require changes in exchange rules. Failure to enforce rules for violation of provisions of the Act may result in CEA orders revoking the market's designation as a contract market or requiring it to cease and desist. By regulation, interested persons may request CEA to institute proceedings, the Commission may act on its own motion, or interested persons may apply for intervention. 409 U.S. at 291–297.

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modity Exchange Act was "the exclusive instrument for the governance of the Exchange and its members," noting that the purpose and structure of the Act and past cases foreclosed that conclusion (409 U.S. at 302, n. 13).[8] This Court expressly held: "Nor do we find that Congress intended the Act to confer general antitrust immunity on the Exchange and its members with respect to that area of conduct within the adjudicative or rule-making authority of the Commission or the Secretary."[9] *Ibid.*

The Court noted four factors in support of this conclusion: the Act contained no categorical exemption of this kind, or indeed, any express exemption; the area of administrative authority was not particularly focused on competitive considerations; no express provision of the Act directed administrative officials to consider the policies of the antitrust laws; and there was no other indication that Congress intended the adjudicative authority conferred to be a complete substitution for judicial enforcement of the antitrust laws. *Ibid.* These factors apply here.

The Court also emphasized that reference to the administrative authorities of questions under the Commodity Exchange Act was justified because it would aid the antitrust court in resolving the immunity question. Thus the holding of *Ricci* is that

[8] The Court cited *Carnation Co.* v. *Pacific Westbound Conference, supra; United States* v. *Philadelphia National Bank, supra; Silver* v. *New York Stock Exchange, supra*; *Pan American World Airways* v. *United States*, 371 U.S. 296; *United States* v. *Borden Co., supra.*

[9] Citing *United States* v. *Philadelphia National Bank, supra*, 374 U.S. at 350–354; *California* v. *Federal Power Commission, supra; Maryland & Virginia Milk Producers* v. *United States*, 362 U.S. 458; *United States* v. *Radio Corp. of America*, 358 U.S. 334, 339–352.

the antitrust courts retain the final authority to determine the effect of a regulatory statute on the antitrust laws: "[T]he question of immunity, as such, will not be before the agency; but if Ricci's complaint is sustained, the immunity issue will dissolve, whereas if it is rejected and the conduct of the Exchange warranted by a valid membership rule, the court will be in a much better position to determine whether the antitrust action should go forward." 409 U.S. at 306. Re-emphasizing this point, the Court stated that "[w]e make no claim that the Commission has authority to decide either the question of immunity as such or that any rule of the Exchange takes precedence over antitrust policies. Rather, we simply recognize that Congress has established a specialized agency that would determine either that a membership rule of the Exchange has been violated or that it has been followed. Either judgment would require determination of facts and the interpretation and application of the Act and the Exchange rules. And either determination will be of great help to the antitrust court in arriving at the essential accommodation between the antitrust and regulatory regime." 409 U.S. at 307.

The four dissenting justices also agreed with the majority that the Commodity Exchange Commission's power to order enforcement of the Exchange's rules did not deprive the courts of power and responsibility to make the accommodation "between usual antitrust principles and the self-regulatory and exclusionary powers that the exchanges were obviously intended to exercise." 409 U.S. at 314.

3. The need for a full record

Silver, Ricci, and the cases on which they are founded, thus make clear that the question of implied repeal of the antitrust laws under any provisions of the Securities Exchange Act, including Section 19(b), is for the antitrust courts, and that in answering this question they may recognize such a repeal only to the minimum extent necessary to achieve the purposes and aims of the 1934 Act. This cannot be determined in the abstract, or on a summary record. Other courts faced with almost identical questions have, therefore, insisted that full records be developed. *Thill Securities Corp.* v. *New York Stock Exchange, supra,* 433 F. 2d at 273 (C.A. 7); *Harwell* v. *Growth Programs, Inc., supra,* 451 F. 2d at 247 (C.A. 5); *Fredrickson* v. *Merrill Lynch, Pierce, Fenner and Smith,* 1974–2 Trade Cases, ¶ 75,227 (N.D. Ill., decided September 9, 1974)

A full record is necessary because the *Silver* test is an aspect of the rule of reason. *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 360; *United States* v. *Terminal R. Ass'n of St. Louis,* 224 U.S. 383, 394–395; *Board of Trade of the City of Chicago* v. *United States,* 246 U.S. 231, 238. Thus, it is not enough simply to challenge exchange rules establishing fixed commission rates as illegal *per se* under the antitrust laws. The defendants must be permitted to show, if they can, that the practice comes within the duty of self-regulation imposed by the Securities Exchange Act and that it meets the *Silver* test. *Kaplan* v. *Lehman Bros.,* 371 F. 2d 409 (C.A. 7), certiorari denied, 389 U.S. 954.

This is shown by the subsequent interpretation of *Kaplan* v. *Lehman Bros., supra,* by the court which

decided it, in *Thill Securities Corp.* v. *New York Stock Exchange, supra.* The district court in *Thill* had granted summary judgment against a complaint challenging a NYSE rule prohibiting the sharing of commissions between members and non-member brokers. It held, like the courts in this case, that the subject of commission rates was the exclusive responsibility of the SEC under Section 19(b). See *Thill, supra,* 433 F. 2d at 267–268.

The court of appeals reversed and remanded for a full trial, noting that "[b]efore the investing public of the United States may be deprived of the benefit of competition through the vehicle of Exchange rules, it must be established that the Exchange's exemption from the antitrust laws is necessary to discharge its responsibilities under the Securities Exchange Act * * *. In short, its exemption must be based on a showing of true necessity." 433 F. 2d at 269. It found "in the teachings of *Silver,* no 'intimation' that the mere possibility of SEC review wraps the conduct of the Exchange in an impregnable shield of antitrust immunity." *Ibid.*

Discussing *Kaplan, supra,* it noted that the plaintiff in that case, by arguing for a strict *per se* rule, had directly contradicted the rule of reason test of *Silver. Id.* at 270. It remanded for a full trial, which has now been completed and is awaiting decision.[10]

[10] Following remand to the district court by the court of appeals, 433 F.2d at 275, the United States intervened as a party plaintiff alleging that the Exchange's anti-rebate rules unreasonably restrict access to the Exchange by non-members. The Securities and Exchange Commission also intervened. After a full trial, which lasted nearly three months, the evidence was closed on February 28, 1973, post-trial briefs and proposed

The Fifth Circuit adopted the same approach in *Harwell* v. *Growth Programs, Inc., supra.*

Here, in contrast, no adequate record has been made. Defendants moved for summary judgment on the basis of their claim that the SEC has exclusive jurisdiction over exchange price fixing. In support they offered only materials showing (1) that the SEC had reviewed their constitution and rules, which included standard commission rates, at the time the exchanges were originally registered in 1934; and (2) that in 1959, and at various times since 1968, the SEC has considered aspects of exchange rate fixing. This showing falls far short of the factual requirement necessary for application of the *Silver* test. Summary dismissal of an antitrust case involving such complex issues is particularly inappropriate. Cf. *Poller* v. *Columbia Broadcasting System,* 368 U.S. 464, 473; *White Motor Co.* v. *United States,* 372 U.S. 253, 259, 261; *Scheuer* v. *Rhodes,* 416 U.S. 232, 250.

C. NEITHER THE LANGUAGE AND STRUCTURE OF THE ACT NOR ITS LEGISLATIVE HISTORY INDICATES THAT EXCLUSIVE JURISDICTION OVER EXCHANGE PRICE-FIXING IS VESTED IN THE SEC

1. The language and structure of the Act

The Securities Exchange Act was designed to preserve the private initiative and responsibility which exchanges enjoyed prior to its enactment; to require

findings were filed; after final oral argument, the case was submitted July 30, 1973 and is presently *sub judice.*

In a subsequent opinion dismissing an appeal by the NYSE from the district court's order denying the Exchange's motion for referral of the issues to the SEC, the Seventh Circuit reaffirmed its ruling. 469 F.2d 14, 15, n. 3. The court also held that primary jurisdiction questions could be resolved on appeal from the final judgment. *Ibid.*

vigorous self-regulation by the exchanges to insure investor protection—to which the Act refers thirty-five times[11]—and to provide for oversight by the SEC, to the extent specified in various sections. The Act contains no provision for issuance of certificates of convenience and necessity to exchange members; no requirement that uniform brokerage tariffs be filed with SEC; no rule of rate-making to assure members a return on their investment; and no requirment that members obtain SEC permission to cease doing business. The Act does not empower the SEC to enforce the antitrust laws through administrative proceedings, or to grant any antitrust immunity to exchanges. Nor does it require that the SEC approve exchange rules before they may be implemented by exchanges.

Section 2 declares that securities transactions on exchanges and over-the-counter markets are affected with a national public interest which makes regulation and control necessary. It emphasizes the Congressional concern with protection of investors from the evils of manipulation and control of prices on exchanges and markets; excessive speculation; and the abuse and excessive use of credit.

Section 6 provides for the registration of exchanges with the SEC, and Section 5 prohibits securities transactions on unregistered exchanges. Section 6 provides, *inter alia,* for registration if it appears to the SEC that the exchange is so organized as to be able to comply with the Act and the rules thereunder, and that its own rules "are just and adequate to insure

[11] *Baird* v. *Franklin,* 141 F.2d 238, 244 n. 4 (C.A. 2), certiorari denied, 323 U.S. 737.

fair dealing and to protect investors." Section 6(b) recognizes that an exchange's rules must provide sanctions against members for conduct inconsistent with just and equitable principles of trade; and Section 6(d) allows registration only if the exchange's organization assures compliance with the Act and rules thereunder, and if the exchange's rules "are just and adequate to insure fair dealing and to protect investors." Thus Section 6(b) and (d) implies an affirmative obligation of exchanges to conduct the process of self-regulation in the public interest, and to enforce the rules they file with the SEC.

Section 19(a) of the Act empowers the SEC to suspend or withdraw the registration of an exchange for violation of the Act or SEC rules, or for failure to enforce its own rules. Section 19(b) permits the Commission itself to make changes in the rules of an exchange, dealing with enumerated subjects including, in Section 19(b)(9), "the fixing of reasonable rates of commission * * *." No procedure is provided in Section 19(b) or elsewhere in the Act by which private parties may challenge exchange rules either at the time of filing or thereafter.[12] Nor does the Act provide that the SEC must approve rules before they may be implemented, or suspend them pending investigation.

However, if an exchange refuses to make changes in its rules requested by the SEC, the agency may alter or amend them with respect to specified subjects. To do this, it must determine, after notice and opportunity for hearing, that "such changes are necessary or appropriate for the protection of investors or to

[12] See *Silver* v. *New York Stock Exchange*, *supra*, 196 F. Supp. at 219–221.

insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange * * *." Section 19(b).

Section 10(a) and (b) contains provisions giving the SEC powers of direct rule making with respect to short sales, stop-loss orders and manipulative or deceptive devices. Section 11(a) and (b) grants similar powers with respect to floor trading, off-floor trading by members, and operations of specialists and odd-lot dealers. Thus, the statute distinguishes between the SEC's reserved powers of oversight over exchange self-regulation, and its power directly to impose requirements on the exchanges with respect to the particular matters enumerated in Sections 10 and 11.[13]

2. The legislative history

The legislative history confirms the primary role given to private initiative in performance of the duty of self regulation, and the reserved role of the SEC's oversight thereof. See *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware, supra,* 414 U.S. at 128, n. 9. This approach had been emphasized in a report by the Roper Committee to President Roosevelt on regulation of exchanges.[14]

Thereafter, legislation to establish a system of

[13] The Act also provides in Sections 7 and 8 for direct control of margin credit by the Board of Governors of the Federal Reserve System. The purpose of this direct regulatory authority is to prevent excessive use of credit. 15 U.S.C. 78g.

[14] The Committee was chaired by then Secretary of Commerce Roper. Letter from the President of the United States to the Chairman of the Committee on Banking and Currency with an Accompanying Report Relative to Stock Exchange Regulation, 73d Cong., 2d Sess. (Committee Print).

regulation was introduced in Congress as H.R. 7852, 73d Cong., and S. 2693, 73d Cong. Strong industry opposition developed, however, and after extensive hearings [15] the legislation was revised and reintroduced, S. 3420, 73d Cong., was reported to the Senate in S. Rep. No. 792, 73d Cong., 2d Sess.; and H.R. 9323 was reported to the House in H. Rep. No. 1383, 73d Cong., 2d Sess. Both reports emphasized that exchanges would be required to exercise a wide measure of economic responsibility and initiative, while the regulatory agency was to stand in reserve, ready to act only if the exchanges failed adequately to protect investors. H. Rep. No. 1383, *supra,* at p. 15; S. Rep. No. 792, *supra,* at p. 13.

The only reference to fixed commission rates of any significance occurred during testimony in the Senate hearings by Samuel Untermeyer. He had been counsel to the "Pujo" Committee which had investigated stock exchange operations for the House of Representatives in 1912 and 1913.[16] The bill under consideration (S. 2693), provided that "the Commission may fix or prescribe the method of fixing uniform rates of commission." Mr. Untermeyer urged that the word "uniform" be stricken because "that would permit the Commission to fix rates * * *." Mr. Untermeyer favored prescription of rates by governmental authority because he believed that "the exchanges charge all

[15] See Hearings before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.), 73d Cong., 1st and 2d Sess. (hereinafter cited as "Senate Hearings"); Hearings before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. (hereinafter cited as "House Hearings").

[16] See H. Rep. No. 1593, 62d Cong., 3d Sess.

that the traffic will bear and that is a burden on commerce." Senate Hearings, p. 7705. Without explanation, the House substituted for "uniform" the word "reasonable," and it was ultimately included in Section 19(b)(9) as passed.

The Senate rejected proposals to strike from the bill the various subjects enumerated in Section 19(b). 78 Cong. Rec. 8591–8592. In the House, the principal concern with this provision was over the procedure for judicial review of Commission action; some legislators feared that without a procedure for review the Commission might fix commission rates at confiscatory levels. Others feared that review could be used to delay and defeat the Commission's exercise of power under Section 19(b). 78 Cong. Rec. 8090–8091. In the end, the bill provided in Section 25(a) for court of appeals review of Commission orders but not Commission rules. See *PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission,* 485 F.2d 718 (C.A. 3), certiorari denied, 416 U.S. 969.

Congress finally enacted, with various modifications, the revised House proposal, H.R. 9323. As we have seen, it empowered the SEC to rule on the fixing of rates should it determine that this was necessary or appropriate for investor protection, fair dealing or fair exchange administration. But the legislative history is barren of any evidence that Congress intended a general repeal of the antitrust laws with respect to the matters enumerated in Section 19(b).[17]

[17] The 73d Congress adopted the Communications Act of 1934 on June 19, 1934. 48 Stat. 1064. It provided in Section 221(a) express antitrust immunity for telephone company mergers approved by the Federal Communications Commission. 47 U.S.C. 221(a). If that Congress had intended a similar im-

As to these it opted for a system of exchange self-regulation under SEC supervision. This method of supervision, it believed, would allow the exchanges sufficient freedom to perform their vital function as capital markets, while providing sufficient government oversight to assure protection of investors.[18] With respect to the other evils which had led to the statute—manipulation and control of securities prices, excessive speculation and the abuse of margin credit—the Act provided for direct regulation. See p. 29, *supra*. See S. Rep. No. 792, *supra*, at p. 5.

Not long after, when the 74th Congress amended the Act in 1936 by adding Section 12(f), authorizing exchanges to deal in unlisted securities (49 Stat. 1375, as amended, 15 U.S.C. 78*l*(f)), the Senate report emphasized that the purpose of the amendment was to "create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets and to allow each type of market to develop in accordance with its natural genius and consistently with the public interest." S. Rep. No. 1739, 74th Cong., 2d Sess., p. 3. Thus the almost contemporaneous legislative construction assumed that competition was highly significant in the securities industry, despite SEC regulation.

This legislative view was further confirmed in 1938, when the 75th Congress adopted the Maloney Act, Section 15A of the Securities Exchange Act, 52

munity to arise under the Securities Exchange Act it was considering about the same time, "Congress doubtless would have said so." *United States* v. *Borden Co.*, *supra*, 308 U.S. at 201.

[18] See testimony of Thomas G. Corcoran, one of the draftsmen of the original bills. Senate Hearings, *supra*, part 15, 6566.

Stat. 1070 as amended, 15 U.S.C. 78*o*–3(a)–(n). This statute provides for regulation of over-the-counter markets by requiring registration with the SEC of brokers and dealers, and of associations of securities dealers whose organization and rules meet the Act's requirements. 15 U.S.C. 78*o*–3(b).

Like exchanges, the associations must regulate themselves by rules, and discipline members who failed to adhere to them. Such rules must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market." 15 U.S.C. 78*o*–3(b)(8). However, the Act specifically bars rules "designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." *Ibid.*

In the Maloney Act, Congress thus expressly made adherence to antitrust principles barring price fixing and discrimination an express condition for registration of broker-dealer associations. The absence of similar language from the provisions for registration of exchanges does not indicate an intent to repeal the antitrust laws with respect to them; rather, the Maloney Act, unlike the exchange section, imposes on the SEC an express duty to take the enumerated antitrust principles into account in reviewing associa-

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tions' rules. The absence of such a requirement from the Exchange Act indicates that the antitrust laws are not repealed. See p. 22, *supra*. The SEC is also specifically empowered to review disciplinary actions by associations against their members—the element missing from *Silver*—and to abrogate rules to assure fair dealing, fair representation of its members in its administration to protect investors, or to effectuate the purpose of the Act; and to alter or supplement the rules with respect to enumerated matters relating to qualifications for membership, the method for changing Association rules, the method of choosing officers and directors, and affiliation between registered securities associations. 15 U.S.C. 78*o*–3 (g), (k).

Finally, Section 15A(n) provides that "[i]f any provision of this Section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail." 15 U.S.C. 78*o*–3(n). This language, however, does not define a specific exemption from the antitrust laws. II Loss, *Securities Regulation*, 1369 (2d ed. 1961)." The only decision authoritatively to construe this provision concluded that it is a legislative statement of the *Silver* test for determining when the Securities Exchange Act prevails over the antitrust laws: "[T]he Maloney Act 'prevails' over any other laws of the United States only to the extent that they conflict. To determine if they conflict, the Maloney Act should be construed to reach only those things necessary to carry out the purposes of the Act." *Harwell* v. *Growth*

[19] But cf. *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 227, n. 60; *International Ass'n of Machinists* v. *Street*, 367 U.S. 740, 809, n. 16 (Frankfurter, J. dissenting); *United States* v. *Morgan*, 118 F. Supp. 621, 693 (S.D. N.Y.).

Programs, Inc., 451 F. 2d 240, 247 (C.A. 5), rehearing denied, 459 F. 2d 461 (C.A. 5).

Thus in the Maloney Act, Congress expressly incorporated certain antitrust principles and made it the duty of the SEC to enforce them as applied to associations of over-the-counter dealers; and as the Fifth Circuit correctly held in *Harwell*, it legislatively anticipated the *Silver* test.[20] The 1938 amendment therefore supports the views expressed in *Silver* that the securities industry is not exempted from the antitrust laws except to the limited extent that the Securities Exchange Act directly conflicts with those laws, even as to matters within SEC's oversight.

D. IN THE ABSENCE OF CLEAR LEGISLATIVE INTENT, THE COURT OF APPEALS HAD NO BASIS FROM WHICH TO INFER THAT THE SEC HAS EXCLUSIVE JURISDICTION OVER PRICE FIXING

1. No pervasive regulatory scheme is substituted for price competition

The language, structure and history of the Act, as set forth above, show that Congress did not intend to substitute a comprehensive, public utility-like system of government regulation for the regime of competition fundamental to private enterprise in other sectors of the economy. The SEC has concisely recognized this in advice to Congress:

> It was not the purpose of the Exchange Act, unlike certain other regulatory statutes, to limit or restrict competition in the securities industry. The purpose of the Exchange Act

[20] In light of the *Silver* decision, the Senate recently passed legislation which would have repealed Section 15A(n), *supra*, on the ground that that section was unnecessary. See n. 25, *infra*.

rather was to protect investors by prohibiting fraudulent, deceptive, or manipulative practices, providing additional disclosure with respect to securities and regulating the operation of the markets in the interest of making them fair, honest, and orderly. The commission consequently does not engage in economic regulation in the sense of awarding exclusive franchises or licenses, fixing or regulating prices or restricting entry into the field upon economic grounds, such as 'public convenience, interest or necessity.' Anyone may enter the securities business unless disqualified either by past misconduct or by lack of training or experience. New exchanges may be established if they are so organized as to be able to comply with the standards of the act and the prices of securities are determined by competitive forces. Similarly, broker-dealers may either compete, or may liquidate, merge or consolidate without authorization from the Commission.[21]

Because the scheme of regulation is thus limited, and because members of the exchanges enjoy the same private initiative as other commercial enterprises, they are subject to the national policy of competition. As the Court has observed: "We have long recognized that the antitrust laws represent a fundamental national economic policy and have therefore concluded that we cannot lightly assume that the enactment of a special regulatory scheme for particular aspects of an industry was intended to render the more gen-

[21] Letter of Hon. Manuel F. Cohen, Chairman, Securities and Exchange Commission, to the Honorable A. Willis Robertson, Chairman, Committee on Banking and Currency, U.S. Senate, July 30, 1965, reported at 111 Cong. Rec. 19021.

eral provisions of the antitrust laws wholly inapplicable to that industry." *Carnation Co.* v. *Pacific Westbound Conference, supra,* 383 U.S. at 218. The absence of a pervasive scheme of regulation to take the place of a regime of free competition distinguishes this case from *Pan American World Airways* v. *United States,* 371 U.S. 296. Congress rejected such a scheme "in favor of voluntary commercial relationships. When these relationships are governed in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws." *Otter Tail Power Co.* v. *United States,* 410 U.S. 366, 374.

2. No exemption by Section 19(b)(9) or by registration of exchanges

(a) The express inclusion of price fixing rules among matters subject to SEC oversight under Section 19(b)(9) does not manifest a legislative purpose to place such conduct exclusively within SEC's jurisdiction. The statutory language itself does not require a fixed commission system. It says only that the SEC may require changes in rules respecting "the fixing of reasonable rates of commission." An exchange or SEC rule abolishing fixed commissions and creating a regime of price competition would be as much within the scope of oversight under Section 19(b)(9) as rules establishing or continuing them.[22]

[22] As one commentator has observed (Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public,* 22 Stan. L. Rev. 675, 690 (1970)): "Section 19(b) does not authorize the NYSE to do anything; it authorizes the SEC to alter or

Moreover, the SEC's powers under Section 19(b) are limited. The Act does not provide that it must approve such rules before they become effective. Nor does it provide that they may be suspended pending investigation. The SEC has advised Congress that it "has no power to prevent the adoption of a particular rule by an exchange, nor to abrogate it once it has been adopted. [Cf. *American Telephone and Telegraph Co.* v. *Federal Communications Commission,* 503 F. 2d 612 (C.A.') (FCC may not require advance approval for filing of carrier-made tariffs).] It does have the power to require alterations in exchange rules [to the extent enumerated in Section 19(b)] but only * * * after following cumbersome procedures." Letter of SEC Chairman Casey to the President of the Senate, December 28, 1971, transmitting SEC Study of Unsafe and Unsound Practices of Brokers and Dealers, H. Doc. No. 92–231, 92d Cong., 1st Sess., pp. 6, 41–42.

Exchange-made commission rates, therefore, are analogous to carrier-made rail rates which have been allowed to become effective by the Interstate Commerce Commission. As to such rates, in contrast to

supplement Exchange rules 'in respect of' 12 enumerated subject-matter areas of great diversity 'and similar matters.' Section 19(b)(9), dealing with one of those enumerated areas, does not even advert to the possibility that the NYSE might fix minimum commission rates, which the SEC might then want to alter or supplement; rather, the type of rule that the Act mentions in describing the Commission's jurisdiction concerns 'the fixing of reasonable rates of commission.' A wide variety of rules answering that description can be imagined—for example, a rule prohibiting agreements among member firms with regard to commissions—that would not violate the antitrust laws."

ICC-prescribed rates, the carriers cannot claim governmental sanction if they are subsequently challenged. *Arizona Grocery* v. *Atchison, T. & S.F. Ry. Co.,* 284 U.S. 370. And the agency's supervisory responsibilities do not foreclose antitrust liability for rate-making agreements concerning such rates, if not immunized by statute. *Georgia* v. *Pennsylvania R. Co., supra.*

With respect to the SEC's dealings with the exchanges concerning their rates between 1934 and the present,[23] the agency has denied that it has engaged

[23] The SEC took almost no action concerning exchange rates until after *Silver* was decided. It has never made any formal determination that the system was necessary to make the Act work. Rather, it has recently adopted Rule 19b–3, prohibiting fixed commission rates. Securities Exchange Act Release No. 11203 (January 23, 1975).

It seems to have questioned an aspect of the New York Stock Exchange's fixed commission rate system for the first time in 1959. See Note, *Informal Bargaining Process: An Analysis of the SEC's Regulation of the New York Stock Exchange,* 80 Yale L. J. 811 (1971); this resulted in certain voluntary modifications by the Exchange in its proposed rate structure (Securities Exchange Act Release No. 5889 (1959) (App. A–247)). Then in 1961, Congress directed the SEC by an amendment to Section 19 of the Act (Section 19(d), 75 Stat. 465, 15 U.S.C. 78s(d)) to investigate the adequacy for the protection of investors of the rules of securities exchanges and securities associations. This resulted in a comprehensive "Special Study of Securities Markets" (hereinafter, "Special Study"), H. Doc. No. 95, 88th Cong., 1st Sess.). The study reported that the rigid fixed rate system adopted by the exchanges had resulted in elaborate efforts by non-members, particularly large institutional investors with economic leverage, to reduce their brokerage costs by requiring exchange members to "give up" commissions as compensation to other brokers, or to engage in certain reciprocal transactions. The study also disclosed that although commission rates were increased five times between

in reviewable "agency action" at all, much less given formal "approval" of the rules. *Independent Broker-Deal. T. Ass'n* v. *Securities & Exchange Commission,*

1934 and 1959, the SEC never undertook a full scale examination of the system, the rate structure or their justification. The Exchanges had not offered, and the SEC had not required regular, systematic and consistent proof of need, nor were there uniform criteria for such essential factors as income, methods for allocating costs to various kinds of business or other standards. Special Study, Part 2, pp. 328–334, 347.

In 1968, for the first time, the Commission conducted a proceeding inquiring into whether a minimum exchange rate structure is necessary to the operation of the securities industry. It was, however, an investigatory hearing under section 21(a) of the Act, 15 U.S.C. 78u(a), seeking only to elicit general information, not a proceeding under Section 19. In 1972, the Commission announced its commitment to the creation of a nationwide central market system for listed securities, and specifically noted that fixed minimum brokerage commissions were a significant barrier to achievement of this result. Statement on the Future Structure of the Securities Market (February 2, 1972). By this time, the Commission had attempted to induce the exchanges to eliminate fixed commission rates for orders in excess of $50,000 (Securities Exchange Act Release No. 9007, October 22, 1970) (App. A–348). In the face of exchange opposition, however, it acquiesced in rule changes which preserved fixed commissions below $500,000. Competitive rates for orders in excess of $300,000 finally were implemented by the Exchange in April 1972.

On June 6, 1973, the Commission announced another public investigatory hearing under Section 21(a) specifically addressed to fixed commission rates (Securities Exchange Act Release 10206, June 6, 1973. On September 11, 1973, it announced its intention to terminate fixed rates after April 30, 1975, if the exchanges did not voluntarily do so. Security Exchange Act Release No. 10383. In response to Commission urgings, the New York Stock Exchange initiated a program of limited price competition for orders under $2,000 (Securities Exchange Act Release No. 10670, March 7, 1974). Finally, on September 19, 1974, acting under Section 19(b), the Commission requested exchanges to eliminate fixed commission rates. In light of a generally negative response from the exchanges, on October 24,

442 F. 2d 132, 137 (C.A.D.C.), certiorari denied, 404 U.S. 828. Thus in *Independent Investor Protective League* v. *Securities and Exchange Commission,* S.D. N.Y., No. 71–1924, dismissed without opinion, November 15, 1971, the agency characterized its letter advising the New York Stock Exchange of its views on proposed rate changes as merely a "non-objection."[24]

(b) The registration of the exchanges with the SEC pursuant to Section 6 of the Act does not constitute a basis for inferring that exchange rules submitted to the SEC with the registration statement are exempt from the antitrust laws. Registration may be granted under Section 6(b) and (d) if the exchanges' rules are just and adequate to insure fair dealing and to protect investors, and are consistent with just and equi-

1974, the SEC announced proceedings on a proposed rule 19b–3 prohibiting the fixing of rates of commission by stock exchanges effective May 1, 1975. Securities Exchange Act Release No. 11073, October 24, 1974. This rule was adopted January 23, 1975. Securities Exchange Act Release No. 11,203, *supra.*

[24] The Preliminary Report to the Senate Securities Industry Study, for the period ending February 4, 1972, page 58, summarized SEC's argument as follows (Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, 92d Cong., 2d Sess. 58 (Committee Print)):

"The SEC argued that it had conducted no 'proceeding', that its letter to the NYSE did not 'approve' the new rates, that it was 'at most in the nature of an interlocutory non-objection,' which 'does not differ materially from the thousands of interpretive and comment letters the Commission sends each year to registrants of securities, broker-dealers, investment advisors, investment companies and public investors seeking guidance,' and that 'the Exchange may adopt a [*sic*] decline to adopt all or any part of its rule proposals at any time, whether or not modified in response to the comments set forth in the Commission's letter.'"

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table principles of trade. 15 U.S.C. 78f(b) and (d). Section 6, however, does not require the SEC to consider competitive factors, much less provide that the act of registration exempts exchanges from the antitrust laws. On the contrary, the Act provides in Section 28 that "[t]he rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity * * *." 15 U.S.C. 78bb.

The exchanges were granted registrations in September 1934, in brief conclusory orders, which reserved the SEC's right to revoke registration or take such other action under Section 19 or other appropriate provisions, as it deems necessary (App. A–37, A–238). See First Annual Report of the Securities Exchange Commission (1935), p. 11. Although each exchange's rules were carefully scrutinized by the SEC's staff, there was no public participation in the registration process, nor was registration accompanied by any articulation of the reasons why the Commission found the rules of the exchanges to conform to the Act. We do not contend that the statute requires either consideration of competitive factors, public proceedings or formal opinions before the SEC can register an exchange. Rather, the absence of such requirements is a strong indication that Congress did not intend registration to cut the public off from rights otherwise assured by the antitrust laws. *Silver* v. *New York Stock Exchange, supra.*

In these circumstances, no claim of immunity from the antitrust laws can arise on the basis of a claimed conflict with the agency's past exercise of its regulatory responsibilities under Sections 6 and 19. This is made clear by *Carnation Co.* v. *Pacific Westbound Conference, supra.* The Court there held that shipping conference rate agreements implemented before receiving approval from the Federal Maritime Commission, which by statute would have immunized them from the antitrust laws, were subject to treble damage liability. Inaction or acquiescence by the regulatory agency likewise forms no basis for immunity. *United States* v. *Borden Co., supra,* 308 U.S. at 198–200, 201; *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 225–227. Here the reasons for non-immunity are even stronger, for nothing in the Act provides for agency approval of price fixing rules, or immunity if it is granted. Cf. *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 350–352.

3. Antitrust jurisdiction complements regulation

The court of appeals erroneously concluded that there is an irreconcilable conflict between judicial and administrative responsibility. The conclusions of the Special Study (*supra,* n. 23) and the threat of antitrust liability which followed, have stimulated SEC exchange officials and Congress to examine the necessity for fixed commission rates.[25] As the House Study

[25] Congress recently has been actively concerned with this subject. A Senate unit conducted extensive hearings and prepared its own securities industry study. Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess. (Committee Print) (hereinafter, "Senate Study"). The Subcommittee concluded that non-competitive rates should be eliminated (Senate Study, pp. 43–63). It also observed that the existence of SEC review authority over particular

(see n. 25, *supra*) observed at p. 163: "[i]n the absence of vigorous regulation in this area over the years by the SEC, private antitrust actions, or the threat thereof, have been the only effective vehicle for inhibiting or challenging exchange excesses."

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aspects of exchange self-regulation did not immunize anticompetitive conduct from the antitrust laws; rather, the *Silver* test applied (Senate Study, p. 227).

A similar investigation was undertaken by a unit of the House. Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 2d Sess. (Subcommittee Print) (hereinafter, "House Study"). It also concluded that the fixed commission rates are not in the public interest (House Study, p. XIV, pp. 131–146) and that the *Silver* test should be applied to fixed commission rates (House Study, pp. 160–167). Out of these investigations and their accompanying hearings emerged three bills: H.R. 5050, 93d Cong., S. 470, 93d Cong. and S. 2519, 93d Cong.

As reported, H.R. 5050 provided for the elimination of all fixed commission rates on securities exchanges by May 1, 1975, except that the SEC could, upon hearing and appropriate findings, continue or reinstitute fixed rates until October 1, 1976. H. Rep. No. 93–1476, pp. 9, 46–48, 66–67. This bill, reported late in the second session of the 93d Congress (November 19, 1974), did not reach the floor of the House for debate.

The Senate passed S. 470, which would have prohibited the denial of membership on the exchanges to financial institutions, as long as fixed commission rates continued to exist. The Senate Report on the bill, S. Rep. No. 93–187, 93d Cong., 1st Sess., p. 3, stated that there were difficulties with any attempt to set a precise date for eliminating any fixed rates, so that "it was decided to leave the speed and the manner in which fixed rates are phased out to the securities industry, the SEC, and the courts." The Senate rejected an amendment which would have empowered the SEC in its discretion to continue fixed minimum rates for transactions under $100,000. The bill passed the Senate 85 to 3. 119 Cong. Rec. S11368–S11387 (daily ed., June 18, 1973).

Subsequently the Senate also passed S. 2519, *supra*, which is designed to implement a central market system. 120 Cong. Rec. S8950–S8958 (daily ed., May 28, 1974). The bill would have modified Section 15A of the Securities Exchange Act (the Maloney Act), which establishes a system of self-regulation for securities dealers operating in the over-the-counter market. Section 15A(n) declares that the Maloney Act prevails over any provision of other laws with which it may conflict. The Senate voted to repeal this as unnecessary, because it concluded that under existing law the antitrust courts retain "jurisdiction to make the ultimate accommodation between antitrust principles and the powers and actions of the self-regulatory organizations." S. Rep. No. 93–865, 93d Cong., 2d Sess., p. 11. The report cites *Silver*, *Ricci*, and the Fifth Circuit's decision in *Harwell* v. *Growth Programs*, *supra*.

The availability of judicial remedies under the antitrust laws under the *Silver* test, supplements rather than conflicts with the SEC's responsibilities. Those remedies operate much like private enforcement of SEC proxy rules under Section 14(a) of the Act, 15 U.S.C. 78n(a). This remedy "provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432. Similarly, even though the SEC has powers of direct regulation under Section 10(b), dealing with manipulative or deceptive practices (see discussion, *supra,* p. 29), the courts have jurisdiction to enforce private claims for violation of this Section or SEC's rules thereunder. See III Loss, *Securities Regulation,* p. 1428 (2d ed. 1961).

By the same reasoning, even though the SEC has powers under Section 19(a) to discipline exchanges which fail to discipline members under their internal

rules for protection of investors, and willful violations of the Act or SEC rules by an exchange may result in a $500,000 fine (Section 32, 15 U.S.C. 78ff), private parties have a right of action as well. *Baird* v. *Franklin, supra.* This remedy is not foreclosed because the Act specifies other remedies. Similarly, the *Silver* test, which emphasizes reconciliation of the judicial and administrative regimes to the maximum extent possible, implies the principle "* * * that agencies and courts together constitute a 'partnership' in furtherance of the public interest and are 'collaborative instrumentalities of justice.'" *Greater Boston Television Corp.* v. *Federal Communications Commission,* 444 F. 2d 841, 851–852 (C.A. D.C.); *United States* v. *Morgan,* 313 U.S. 409, 422.

The 1963 Special Study (n. 23, *supra*) recognized that in the absence of effective competition, much more extensive and detailed regulation by the government would be necessary. The antitrust laws, by protecting competition in the securities industry, thus provide an essential complement to existing regulation.[26]

[26] Special Study, Part 2, p. 957:

"The extent of needed regulation of markets in the public interest surely depends, at least in part, on the effectiveness of competition among markets—not merely competition for the handling of transactions in multiple traded securities but competition to become the primary market for particular securities—in maintaining high standards of performance. Indeed, in the absence of effective competition among markets in both senses, the sheer size and power of any one or two markets might enlarge the scope and degree of needed governmental intervention to the point where the adequacy of present regulatory concepts would be open to question. Considerations of this kind appear to have entered into the Commission's expressions of policy on unlisted trading privileges in 1936 and multiple trading in 1940. (See pt. E.) Although the context may have changed somewhat, these considerations have at least equal pertinence today."

4. Legislative awareness of exchange price fixing

The court of appeals' emphasis upon the fact that the Act was adopted seven years after *Trenton Potteries* is also misplaced. As we have seen, Congress was aware from Mr. Untermeyer's testimony that exchange members have continuously set the rates of commission to be charged their customers by agreement. But there is no evidence that Congress' attention was ever meaningfully called to any link between *Trenton Potteries* and exchange price fixing.

Absent such evidence no inference of a legislative intention to declare *Trenton Potteries* inapplicable may be drawn. "It is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law" (*Girouard* v. *United States,* 328 U.S. 61, 69), much less a policy change as grave as repeal of the antitrust laws. See also *National Labor Relations Board* v. *Plasterers' Union,* 404 U.S. 116, 129–130. It was not clear even as late as 1934 that the Sherman Act could be applied to exchange practices.

Argument was then still current as to whether exchange transactions were within the reach of the Federal Commerce Power.[27] Only two decades earlier, in 1913, the Pujo Committee had reported that exchange price fixing had only local effect and thus was appar-

[27] See Tracy and MacChesney, *The Securities Exchange Act of 1934,* 32 Mich. L. Rev. 1025, 1037, n.* (1934).

ently beyond the power of Congress. H. Rep. No. 1593, 62d Cong., 3d Sess., pp. 114–116. Cf. *Federal Baseball Club* v. *National League,* 259 U.S. 200. Not until 1950, when this Court held in *United States* v. *National Ass'n of Real Estate Boards,* 339 U.S. 485, that rate fixing by an association of real estate dealers was a *per se* violation of the Sherman Act, was the validity of exchange price fixing under the antitrust laws first questioned.[28]

5. Inconsistent results

The court of appeals' fear that application of the *Silver* test is likely to subject exchanges to repetitive and conflicting standards misconceives this court's reasoning in that case. The intent and the effect of *Silver* is to provide a mechanism for reconciliation of the two statutes' schemes. If the SEC were to order the exchanges to adhere to a fixed commission rate system of some kind, no antitrust liability could arise. *United States* v. *Borden Co., supra,* 308 U.S. at 201; *Parker* v. *Brown,* 317 U.S. 341.

But the SEC has never made such an order. Moreover, it is always possible to include in antitrust decrees language which provides for the contingency that it will do so. *Otter Tail Power Co.* v. *United States, supra,* 410 U.S. at 375; *United States* v. *Terminal R. Ass'n of St. Louis, supra,* 224 U.S. at 412.

The likelihood that the SEC will adopt such an order seems remote. Until October 1974 it had con-

[28] See II Loss, *Securities Regulation*, p. 1179, n. 29 (2d ed. 1961).

ducted only two proceedings under Section 19(b)[29] and it has never indicated in any formal action that fixed commissions are necessary to the scheme of the Act. It has instead moved steadily in the direction of considering administrative abolition of the fixed commission rate system (see n. 23, *supra*), culminating in its announcement January 23, 1975, of Rule 19b–3, prohibiting fixed rates to the public as of May 1, 1975, and to members and associated members (floor brokerage) as of May 1, 1976.[30]

Moreover, the *Silver* test is applicable to action of the Commission as well as of the courts. Most of the exchange rules subject to Section 19(b) do not affect

[29] The first was *In the Matter of the Rules of the New York Stock Exchange*, 10 S.E.C. 270. In that case, the Commission abrogated a New York Stock Exchange rule designed to suppress trading on regional exchanges. It held that the fostering of competition among exchanges was one of the purposes of the Securities Exchange Act. The second involved institutional membership in exchanges. On January 16, 1973, the Commission adopted Rule 19b–2, which ordered every exchange to limit membership to those whose "principal purpose" is the conduct of a "public securities business." Securities Exchange Act Release No. 9950, January 16, 1973. Adoption of the Rule followed several requests, both informal and formal, by the SEC to the exchanges to restrict "institutional membership" and resistance by certain of the exchanges, particularly the Philadelphia-Baltimore-Washington Exchange, to these requests. The Rule was challenged by the PBW Exchange in the Third Circuit, but the petition was dismissed on jurisdictional grounds. See *PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission, supra.* Judicial challenge to the Rule is currently continuing in the District Court. *PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission*, Civ. Act. No. 74–1198 (E. D. Pa.).

[30] Securities Exchange Act Release No. 11203, January 23, 1975.

competition at all. But competition must be considered by the Commission in weighing the impact on the investing public of exchange rules which do affect competition, because preservation of the competitive free enterprise system is a fundamental national policy. Thus, in barring fixed rates, the SEC said that its "conclusions are consistent with the American tradition of reliance upon free competition to determine prices and allocate resources, as reflected by the public policy embodied in the antitrust laws."[31] See also *In the Matter of the Rules of the New York Stock Exchange,* 10 S.E.C. 270.

This Court has noted that the antitrust laws are the appropriate starting place for determination of the public interest, and that "once an antitrust violation is established, this alone will normally constitute substantial evidence that the agreement is 'contrary to the public interest,' unless other evidence in the record fairly detracts from the weight of this factor." *Federal Maritime Commission* v. *Svenska Amerika Linien,* 390 U.S. 238, 245–246. Accord *Gulf States Utilities Co.* v. *Federal Power Commission,* 411 U.S. 747; *Denver & R. G. W. R. Co.* v. *United States,* 387 U.S. 485; *Otter Tail Power Co.* v. *United States, supra; California* v. *Federal Power Commission, supra.*

Since the purpose of the Securities Exchange Act is to protect investors, not to insulate members of exchanges and dealers in over-the-counter markets from competition, the SEC must apply the *Silver* test in the

[31] Securities Exchange Act Release No. 11203, *supra,* at p. 24.

same manner as a court. Exchange rules which have a significantly adverse effect on competition—as for example fixed commission rates or rules denying access to the exchange—are seriously anticompetitive. Where this is so, it must be presumed that the rule operates to the detriment of the investing public and can therefore be deemed by the SEC to be "necessary or appropriate" under Section 19(b) only to the extent such a restriction on competition is necessary to the operation of the Act and no more restrictive than necessary. The SEC and the courts are thus required to apply essentially the same standard to self-regulatory activities which are seriously anticompetitive, and SEC's recent prohibition of fixed rates reflects this approach.

6. Fixed commission rates as a keystone of the marketing system

The court of appeals also appears to have assumed that the fixed commission rate system was essential to the functioning of securities markets, since it characterized the rate structure as "the keystone of the economic viability of the brokerage industry" (Pet. App. 44). This statement, made without the kind of evidentiary record required by *Silver* (see discussion, *supra,* pp. 17–26), is unsupported.

It is a view rejected by the SEC itself, since the Commission has ordered the prompt abolition of fixed commission rates; and by the legislative bodies which have considered the question. The Senate has adopted legislation which would abrogate fixed rates unless exchanges granted membership to institutional inves-

tors (S. 470, 93d Cong.; see S. Rep. No. 93–187, *supra,* at p. 3), and the House Committee on Interstate and Foreign Commerce also reported legislation which would require abolition of a system it characterizes as unreasonable (H.R. 5050, 93d Cong.; see H. Rep. No. 93–1476, *supra,* at pp. 46–48). Similar conclusions were reached by the House and Senate Studies of the securities industry (*supra,* n. 25).

Moreover, none of the economic factors which would characterize a regulated monopoly pricing system is reflected in the scheme of the Act. Exchange members have no statutory duty to serve all members of the public without discrimination; and the nature of the service offered, operating costs, firm size, and comparative efficiencies between firms vary widely. Because cost data for various kinds of services characteristic of public utility rate making are not available, the SEC has never attempted to apply traditional rate of return criteria to exchange rates.[32] See Securities Exchange Act Release No. 11,203, *supra,* pp. 9–10, 28–30.

Instead, it has advised Congress that no general rate

[32] See, *e.g.*, letter of SEC Chairman Casey to Chairman Harrison A. Williams, Jr., Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, December 3, 1971, Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, on S. 3169, Stock Exchange Commission Rates, 92d Cong., 2d Sess., pp. 30–32; and letter of SEC Chairman Cook to Chairman Harrison A. Williams, Jr., Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, April 10, 1973.

structure can be devised.[33] The only sense in which fixed commission rates have been a "keystone" is that they have been in effect since the New York Stock Exchange was established under a buttonwood tree in 1792. This hardly indicates that Congress intended to authorize them in the Securities Exchange Act, and as we have seen, nothing in the history of that Act reflects a purpose by Congress to endorse this profitable, but hardly necessary practice.[34]

The court of appeals concluded that because the fixed commission rate structure is so ancient, the consequence of introducing competitive rates would be the failure of a number of inefficient brokerage firms (Pet. App. 47). It noted that SEC studies show "that the exchanges have operated for a long time under cartelized commission rates, which exceed those which would have been charged by firms of efficient scale" and suggested that "[m]easured withdrawal could avoid the loss of * * * investor funds by allowing failing brokers to 'exit by orderly merger or liquidation rather than by bankruptcy.'" *Ibid.* This observation, we submit, confirms the wisdom of applying the *Silver* test.

[33] Testimony of Commissioner Loomis, Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, on H.R. 5050 and H.R. 340, Securities Exchange Act Amendments of 1973, 93d Cong., 1st Sess., Part 2, p. 482.

[34] See Baxter, *supra,* 22 Stan. L. Rev. at p. 676. Prof. Baxter observes that in 1792 "the ink was hardly dry on Adam Smith's seminal treatise advocating the social desirability of free and competitive markets * * *" (*ibid.*).

If, as the SEC now has indicated, fixed commission rates are inconsistent with the Securities Exchange Act, then the only ground for permitting them to continue for even a brief time is because a transition period of some kind is necessary for investor protection. Under the *Silver* test, such a transition period might be justified on a proper record. The fashioning of equitable relief to allow such a transition, if fixed commission rates are found to violate the antitrust laws, would be consistent with both traditional doctrines of antitrust relief and equitable principles. This Court has long recognized the powers of a court of equity to fashion relief in a flexible manner taking practical considerations relating to the public interest into account. Cf. *United States* v. *E. I. duPont de Nemours & Co.*, 366 U.S. 316; see also *Hartford-Empire Co.* v. *United States*, 323 U.S. 386; and *United States* v. *Aluminum Co. of America*, 91 F. Supp. 333, 419 (S.D. N.Y.).

Since private antitrust remedies include damages, as well as equitable relief, there remains a question of retroactive damage liability. Whether such liability should be imposed in view of the long history of reliance by the exchanges on the absence of any challenge to their price fixing practices from 1792 to the decade of the 60's is a question which would have to be considered if this or other cases, after application of the *Silver* test, should result in a determination of liability and reach the issue of damages. Given the long history of fixed commission rates, the absence of any challenge to them by anyone until after the 1963

Special Study (n. 23, *supra*) and the relative recentness of *Silver*, there may be equities justifying prospective application of any decision holding commission rate fixing illegal under the antitrust laws, except as to the particular plaintiffs involved. Cf. *Simpson* v. *Union Oil Co.*, 396 U.S. 13, 14; *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 105–109. But these must be considered on a full record after *Silver* has been applied.

7. "Chilling" exchange self-regulation

The SEC has argued (SEC Memorandum as Amicus Curiae, p. 8) that application of the *Silver* test will chill the willingness of the exchanges to engage in self-regulatory activity, and affect the manner in which it exercises its supervisory authority. *Silver*, however, rejected the Second Circuit's "chilling" analysis in that case, and its reiteration here is simply a reversion to a rejected standard. Moreover, insofar as the SEC claims exclusive jurisdiction, it would be claiming an unprecedented power to grant exemption from the antitrust laws without any statutory indication that the Congress intended to delegate to it the power to immunize.[35]

To construe the Securities Exchange Act so that the antitrust laws were applicable only where the Commission affirmatively disapproves exchange rules would stand on its head this Court's decision in *Carnation Co.* v. *Pacific Westbound Conference, supra*. *Carnation* applies *a fortiori* here, where the SEC is

[35] See *United States* v. *Borden Co.*, *supra*; *United States* v. *Philadelphia National Bank*, *supra*, 374 U.S. at 350–355.

not authorized to approve rate fixing agreements prior to implementation, much less to immunize them. Moreover, such a construction would overrule *Ricci's* authoritative interpretation of *Silver* and undermine the salutary principle of *Silver* itself.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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JANUARY 1975.

APPENDIX

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, are as follows:

NECESSITY FOR REGULATION AS PROVIDED IN THIS TITLE

SECTION 2. For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchange and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of

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credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted througout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet

such emergencies the Federal Government is put to such great expense as to burden the national credit.

* * * * *

TRANSACTIONS ON UNREGISTERED EXCHANGES

SECTION 5. It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 6 of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration.

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SECTION 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any

amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this title shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this title and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

* * * * *

OVER-THE-COUNTER MARKETS

* * * * *

SEC. 15A [As added in 1938 by the Maloney Act, 52 Stat. 1070 (15 U.S.C. 78o–3)]. (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below, specified:

(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules

and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

(2) Copies of its constitution charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the "rules of the association."

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section;

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section;

(3) the rules of the association provide that any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) of this subsection: *Provided*, That the rules of the association may restrict membership in such association on such specified geographical basis, or on such specified

basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section;

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if (1) such broker or dealer, whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade, or (B) is subject to an order of the Commission denying or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or (C) by his conduct while employed by, acting for, or directly or indirectly controlling or controlled by, a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B)

which is in effect with respect to such broker or dealer;

(5) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs;

(6) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration;

(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fixed minimum rates of commissions, allowances, discounts, or other charges;

(8) the rules of the association provide that its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules;

(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and the denial of membership to any broker or dealer seeking membership therein. In any proceeding to determine whether any member shall be disciplined, such rules shall require that specific charges be brought; that such member shall be notified of, and be given an opportunity

to defend against, such charges; that a record shall be kept; and that the determination shall include (A) a statement setting forth any act or practice in which such member may be found to have engaged, or which such member may be found to have omitted, (B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation, (C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade, and (D) a statement setting forth the penalty imposed. In any proceeding to determine whether a broker or dealer shall be denied membership, such rules shall provide that the broker or dealer shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial is based; and

(10) the requirements of subsection (c), insofar as these may be applicable, are satisfied.

* * * * *

(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall re-

voke the registration of such affiliated securities association.

* * * * *

(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order, unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

(k)(1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this title.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a

reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to: (1) The basis for, and procedure in connection with, the denial of membership or the disciplining of members; (2) the method for adoption of any change in or addition to the rules of the association; (3) the method of choosing officers and directors; and (4) affiliation between registered securities associations.

(1) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section;

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof who the Commission finds (A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any

rule or regulation thereunder, or (B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation;

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

(m) Nothing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail.

* * * * *

POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SECTION 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this title or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not

exceeding twelve months, or to withdraw, the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the

evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

* * * * *

EFFECT ON EXISTING LAW

SECTION 28. (a) The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under

the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

(b) Nothing in this title shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this title or the rules and regulations thereunder.

The pertinent provisions of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, *et. seq.* are as follows:

SEC. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal: * * * Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

SEC. 2. Every person who shall monopolize, or attempt to monopolize, or combine or con-

spire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

The pertinent provisions of the Clayton Act, 38 Stat. 731, 737, 15 U.S.C. 15, 26, are as follows:

SEC. 4. That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

SEC. 16. That any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections two, three, seven, and eight of this Act, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue: * * *

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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

against

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION OF THE RETIREMENT BOARD OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION OF THE RETIREMENT BOARD OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to Rule 42 of the United States Supreme Court Rules, the Retirement Board of the Teachers' Retirement

System of the City of New York (the "applicant") respectfully moves this Court for leave to file an *amicus curiae* brief herein urging reversal.

The consent of the attorneys for the petitioner herein has been obtained, but the attorneys for one of the respondents herein has refused to consent to the filing of a brief by the applicant as *amicus curiae*.

The applicant has an interest in this case in that the central question involved is the legality of the "fixed commission rates" charged by the New York Stock Exchange, Inc. and the American Stock Exchange, Inc. The primary function of the applicant is the administration of the Teachers' Retirement System of the City of New York, pursuant to Chapter 20, Title B, of the Administrative Code of the City of New York, under which it is vested with the responsibility for the investment of substantial annuity and pension funds for the benefit of public school teachers in the City of New York. Because of the wide diversity of applicant's securities investments, as required by law, the extremely large volume of funds administered by the applicant, and a conservative investment portfolio dictated by public policy, it deals almost exclusively through member firms of the New York Stock Exchange, Inc. and the American Stock Exchange, Inc., which exchanges are the primary markets for the public sale of securities. As a result, applicant must pay onerous commission fees which are fixed by these exchanges at an unreasonably high level in view of the actual cost of the services provided.

The *amicus curiae* brief will present facts and statistics relating to the economic impact of the fixed commission schedules of the major exchanges upon the retirement benefits of a large class of public employees. The brief of the petitioner herein in the Court of Appeals for the Second Circuit does not present such information, and applicant has no reason to believe that such information will be presented by the parties before this Court.

Such information is relevant to the disposition of this case in that it will demonstrate that fixed commission rates are contrary to the general public interest, are not consistent with the purposes and policies of the federal securities laws and are not necessary to make the Securities Exchange Act work.

In a case such as this where the petitioner stands in the stead of an extremely large and diverse class of investors, it is especially important that *amici curiae* be permitted to assist in the full presentation of the facts, issues and arguments.

We believe that Rule 42(4) of the United States Supreme Court Rules permits applicant to file an *amicus curiae* brief without proceeding by motion. However, this motion is being made as a protective measure in case a question is raised as to applicant's standing to so file.

For the foregoing reasons, it is respectfully requested that applicant's motion for leave to file an *amicus curiae* brief herein urging reversal be granted, or, in the alternative, that it be denied on the ground that applicant may

proceed without motion under Rule 42(4) of the United States Supreme Court Rules.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

RICHARD A. GORDON, etc.,
Petitioner,

against

NEW YORK STOCK EXCHANGE, INC., et. al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

OBJECTIONS TO MOTION OF THE RETIREMENT BOARD OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

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December 27, 1974

IN THE

Supreme Court of the United States

October Term, 1974

No. 74-304

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OBJECTIONS TO MOTION OF THE RETIREMENT BOARD OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Respondents object to the motion of the Retirement Board of the Teachers' Retirement System of the City of New York (the "applicant") for leave to file an *amicus curiae* brief herein.*

Applicant is not a "political subdivision" of a state and is therefore not entitled to file an *amicus curiae* brief under Rule 42 of the Rules of this Court without proceeding by motion.

Applicant proposes to present "facts and statistics relating to the economic impact of the fixed commission schedules of the major exchanges upon the retirement benefits of a large class of public employees." (Motion,

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* Contrary to applicant's assertion (Motion, p. 2) none of the attorneys for any of the respondents has consented to the filing of an *amicus* brief by applicant.

p. 3) Such information is irrelevant to the issue presented for consideration by this Court—whether by reason of Section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78s(b)) the respondent exchanges' rules fixing commissions to be charged by their members are exempt from antitrust attack. The economic impact of these rules is simply not relevant to a determination of the antitrust exemption issue, which is solely a question of law.

Moreover, the facts which applicant wishes to present are evidentiary, not a part of the record in this case or judicially noticeable and, accordingly, cannot properly be presented to this appellate tribunal. Likewise, petitioner has not made any arguments based on economic impact. Thus, this Court should not consider such facts. *Knetsch* v. *United States,* 364 U.S. 361, 370 (1960). Therefore, applicant's motion should be denied.

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No. 74-304

RICHARD A. GORDON, individually and as President of INDEPENDENT INVESTOR PROTECTIVE LEAGUE, an incorporated association, and in behalf of the membership thereof and in behalf of all persons similarly circumstanced,

Petitioners,

against

NEW YORK STOCK EXCHANGE, INC., AMERICAN STOCK EXCHANGE, INC., and MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and BACHE & COMPANY, INC., individually and as representatives of all member firms of the New York Stock Exchange and American Stock Exchange,

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IN THE

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BRIEF OF THE RETIREMENT BOARD OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK AS *AMICUS CURIAE*

The Retirement Board of the Teachers' Retirement System of the City of New York ("Retirement Board") respectfully submits this brief as *amicus curiae,* and urges

reversal of the judgment of the United States Court of Appeals for the Second Circuit entered in this case on June 28, 1974.

Question Presented

The central question presented by this case is whether the practice of the nation's stock exchanges of fixing and enforcing schedules of minimum brokerage commission rates is subject to the scrutiny of an antitrust court.

Put another way, the question is whether the Securities Exchange Act of 1934, 15 U.S.C. §78a, et seq. (the "1934 Act"), because it permits the Securities and Exchange Commission ("SEC") to review exchange commission rate rules, among other things, impliedly repeals the antitrust laws to the extent they might affect the "fixed commission rates" charged by exchange members.

Interest of the Retirement Board

The Retirement Board administers the Teachers' Retirement System of the City of New York, pursuant to Chapter 20, Title B, of the Administrative Code of the City of New York, under which it is vested with the responsibility for the investment of substantial annuity and pension funds for the benefit of more than 95,000[1] active and retired public school teachers and administrators in the City of New York.

1. As of June 30, 1974.

The total pension funds administered by the Retirement Board are in excess of $2.4 billion of which approximately $843 million[2] is invested in common stock in connection with a Variable Annuity Program in which over 75% of the teacher members participate. Because of the wide diversity of the investments made in connection with its Variable Annuity Program, as required by law,[3] the extremely large volume of funds administered by it,[4] and a conservative investment portfolio dictated by public policy, the Retirement Board deals almost exclusively through member firms of the New York Stock Exchange, Inc. ("NYSE") and the American Stock Exchange, Inc. (collectively, the "Exchanges"), which Exchanges are the primary markets for the public sale of securities.

For a number of years the Retirement Board has believed that the minimum brokerage commission fees fixed by the Exchanges are at an artificially high level in view of the actual cost of the services provided. It has long been the Retirement Board's belief that brokerage commission should pay only for the execution of trades, and that the size of the commission should be governed only by the costs of execution. However, the rigid rate structure imposed by the Exchanges includes in the established commission fees the cost of a wide spectrum of services which

2. Market value as of June 30, 1974.

3. Administrative Code of City of New York §B20-57.0d.

4. Although the dollar volume of transactions executed on behalf of the Retirement Board on the New York and American Stock Exchanges exceeded $185 million for the fiscal year ended June 30, 1974, most of that amount consisted of transactions of less than $300,000, as to which Exchange rules prohibit negotiated commission rates. Even in transactions exceeding the $300,000 cut-off, however, Exchange rules permit negotiated rates only as to the portion in excess of the cut-off. New York Stock Exchange Constitution, Article XV, §§2, 4.

are ancillary to trading execution or brokerage, whether or not a customer takes advantage of such services.[5]

In an effort to retain their share of the brokerage business, the member firms of the Exchanges have developed the practice of providing ancillary services to customers which go beyond the brokerage function. These services must somehow be paid for. It was inevitable that the firms would offset the cost of these services by utilizing a portion of the commissions received. This has led to inflated commission rates.

While the Retirement Board strongly advocates a fully competitive brokerage commission structure, it has felt obliged to avail itself of such ancillary services to ameliorate to some extent the harsh impact of the existing rate structure. It has been forced, in other words, to take unnecessary services in an effort to get some value for its beneficiaries' money. Thus, not only does the fixed minimum brokerage fee structure have a damaging impact on the retirement benefits of a large class of public employees by compelling payment of fees for extraneous services, but it also results in an unreasonable restraint on competition on the part of the Exchanges in that it facilitates the control by their member firms over the brokerage-related service industries.

As the custodian and administrator of substantial investment funds held for the benefit of public employees the Retirement Board has an interest in challenging the practices of the Exchanges and their members which it believes

5. *See,* Note, *The New York Stock Exchange Minimum Commission Rate Structure: Antitrust on Wall Street,* 55 Va. L. Rev. 661, 663 (1969). These ancillary services include the safekeeping of customer securities, collection of dividends, forwarding proxy materials, furnishing investment advice and obtaining market quotations.

impinge unlawfully on the integrity of the investment programs under its aegis.

The District Court and Court of Appeals below held that the courts do not have jurisdiction to entertain an antitrust attack on the fixed minimum commission structure of the Exchanges. The Retirement Board takes the position that this result is contrary to the general public interest and to the interests of the members of the Teachers' Retirement System of the City of New York, that it is not consistent with the purposes and policies of the federal securities laws, and that it is not necessary to make the Securities Exchange Act work. Further, this holding leaves investors with no forum in which to challenge effectively the practice of price-fixing in the brokerage industry and may have the effect of foreclosing court challenge of other industry practices as well.

Statement of the Case

This private antitrust action was instituted on April 2, 1971 by Richard A. Gordon against the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and two representative member firms of the Exchanges. The complaint has been treated by the courts below as well as all the parties, as a "broadside attack on the present commission structure of the Exchanges"[6] under the Sherman

6. See the District Court decision herein, 366 F. Supp. 1261, 1262 (S.D.N.Y. 1973). The Court of Appeals characterized the claim "that the exchange practice of fixing commission rates violated the Sherman Act" as the "principal allegation" of the complaint. 498 F.2d 1303, 1305 (2d Cir. 1974). Respondents' Statement in Support of the Issuance of a Writ of Certiorari (at p. 2) describes the complaint as a challenge to the Exchanges' practice of fixing minimum commission rates as an "illegal price fixing conspiracy."

Act, 15 U.S.C. §§1, 2, and the Robinson-Patman Act, 15 U.S.C. §13(a). The suit, which was brought by petitioner on his own behalf and on behalf of a class of investors alleged to have been injured by Exchange practices, seeks injunctive relief as well as damages.

On December 4, 1973 the District Court for the Southern District of New York (Lasker, J.) granted respondents' motion for summary judgment and dismissed the complaint on the ground that the court lacked subject matter jurisdiction, jurisdiction to entertain an antitrust attack on the fixed minimum commission structure of the Exchanges, since the fixing of commissions falls within a congressional policy of exchange self-regulation embodied in §19(b) of the 1934 Act, 15 U.S.C. §78s(b).

The Court of Appeals (per Kaufman, C.J.) affirmed the District Court's ruling, holding that under the rationale of this Court's opinion in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963) (Justices Stewart and Harlan dissenting), the oversight authority of the SEC pursuant to §19(b)(9) of the 1934 Act, 15 U.S.C. §78s(b)(9), gives rise to the antitrust immunity, and that the history, language, and policies of the 1934 Act manifest a congressional intent to exempt from the antitrust laws the Exchanges' practice of fixing minimum commission rates.

Summary of Argument

I The courts have been reluctant to find implied antitrust exemptions.

A. An antitrust exemption will not be implied unless a regulatory agency is responsible for performing the antitrust function. Nothing in the regulatory scheme under the 1934 Act requires the SEC to perform the antitrust function in its regulation of securities exchanges. A different case is presented by the Maloney Act, 15 U.S.C. §78o-3, under which the SEC regulates national securities associations.

B. SEC review of exchange activities is not so "pervasive" as to require an antitrust repealer. A principal purpose of the 1934 Act was to limit the self-regulatory conduct of exchanges. The "review" authority over exchange rulemaking conferred upon the SEC by §19(b) of the 1934 Act, 15 U.S.C. §78s(b), is confined within very narrow limits. The SEC has formally exercised its authority under §19(b) only infrequently. No mention is made in the statutory scheme of *minimum* fixed commission rates.

II A. "Self-regulatory" conduct of securities exchanges is immune from the antitrust laws only to the minimum extent necessary to make the 1934 Act work. *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963). A determination that the SEC has review authority over exchange commission rates does not dispose of this case,

but is merely the first step of inquiry required under the *Silver* doctrine. The cases interpreting *Silver* and recent reports of Congressional Subcommittees adopt this view.

B. Antitrust immunization of exchange price-fixing practices is not necessary to make the 1934 Act work. The District Court failed to make an evidentiary determination of such necessity. The determination of whether antitrust repealer is necessary in a given case is to be made by the courts and not the SEC. Fixed commission rates are not necessary for the achievement of the objectives of the 1934 Act.

III Ouster of antitrust jurisdiction will leave petitioner's class with no effective redress of its claims. The SEC has exercised its supervision over exchange ratemaking largely by informal action not subject to judicial review. Antritrust ouster will discourage meritorious private challenges to excessive exchange practices.

ARGUMENT

I

Neither the statutory framework nor the legislative history of the Exchange Act demonstrates a congressional intent to immunize fixed commission rates from antitrust challenge.

Because of the paramount importance of fully competitive markets in our national economic policy as expressed in the Sherman Act, 15 U.S.C. §§1-7, express exemptions from the antitrust laws have been narrowly con-

strued by the courts. Implied exemptions have rarely been found. This Court has repeatedly declined to find a legislative intent that a congressionally enacted regulatory scheme displace the antitrust laws in the absence of an unambiguous declaration of Congress to that effect. *See, e.g., Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726 (1973); *California* v. *FPC*, 369 U.S. 482, 485 (1962); *United States* v. *Radio Corp. of America*, 358 U.S. 334 (1959); *Georgia* v. *Pennsylvania R.R.*, 324 U.S. 439 (1945); *United States* v. *Borden Co.*, 308 U.S. 188 (1939).

The 1934 Act does not contain any express repealer of the antitrust laws. To the contrary, §28 of the 1934 Act, 15 U.S.C. §78bb, expressly preserves "the rights and remedies that may exist at law or in equity." This would include the remedies provided by the antitrust laws. Thus, if any repealer of the antitrust laws is to be found with respect to the conduct and practices of securities exchanges subject to the 1934 Act, it must be implied from the statutory language or legislative history.

A finding of such implied repealer with respect to the price-fixing practices of the Exchanges would appear to contravene this clear statutory language preserving existing remedies. Even in the absence of such language, a finding of implied repealer would not be justified.

As this Court said in *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 350-51 (1963):

> "Repealers of the antitrust laws by implication from a regulatory statute are strongly disfavored and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions."

No such demonstration of irreconcilable conflict has been made in regard to the price-fixing practices of the Exchanges being challenged in this case.

A. The 1934 Act does not empower the SEC to perform the antitrust function.

In determining whether an antitrust exemption should be implied because of a broad regulatory statute, this Court has listed several important criteria. First, an exemption will not be implied unless the regulatory agency is responsible for enforcing some "competitive standard clearly delineated by [statute]." *United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 351. This Court has followed a clear policy of refusing to oust the courts of antitrust jurisdiction in favor of a regulatory agency, unless the agency has a congressional mandate to perform the antitrust function. In *United States* v. *Radio Corp. of America,* 358 U.S. 334 (1959), in which an exchange of television stations was attacked as violative of the Sherman Act, it was contended that the Federal Communications Commission was vested with primary jurisdiction to determine the controversy. The Court, in rejecting this argument, held that the Commission lacked the statutory power to determine antitrust controversies since its supervisory powers were based on a broad standard of "public interest," convenience, and necessity rather than on antitrust criteria. Similarily, in the case of *California* v. *Federal Power Commission,* 369 U.S. 482 (1962), this Court held that the FPC lacked statutory authority to adjudicate anti-

trust issues and therefore could not pre-empt the Court's antitrust jurisdiction.[7]

There is nothing in the regulatory scheme under the 1934 Act which requires, or even permits, the SEC to perform the antitrust function in its regulation of securities exchanges. The most that can be said is that the SEC has the authority to intervene in exchange activities "for the protection of investors or to insure fair dealing in securities * * *." 15 U.S.C. §78s(b). This direction to enforce fiduciary standards certainly does not amount to a mandate to the SEC to weigh antitrust factors in its regulation of the Exchanges. There was no finding by either of the Courts below as to what weight the SEC has attached to antitrust factors in its "review" of exchange price-fiixng practices, or, indeed, as to whether the SEC has taken antitrust considerations into account at all. Clearly an inquiry on a determinative issue was omitted.

The absence of antitrust language in the sections of 1934 Act which provide for the regulation of securities exchanges takes on a special significance when viewed in the light of certain of the Act's other provisions, specifically the Maloney Act, 15 U.S.C. §78o-3. Under the Maloney Act, a 1938 amendment to the 1934 Act, the SEC is vested with regulatory supervision of national securities associations, such as the NASD. The Maloney Act expressly exempts such securities associations from the application of conflicting laws, 15 U.S.C. §78o-3(n). Further, the Maloney Act demonstrates that Congress has *expressly pro-*

7. While these cases involved the issue of primary jurisdiction rather than antitrust repealer, they are closely analogous to the case at bar and their reasoning is persuasive.

vided review standards which perform the antitrust function where it has intended a regulatory scheme administered by the SEC to be exempt from the operation of the antitrust laws.[8] The Maloney Act, §15A(b)(8), 15 U.S.C. §78o-3(b)(8), sets forth as a requirement for the registration of national securities associations with the SEC the promulgation of rules which

> "• • • are designed • • • to provide safeguards against unreasonable profits or unreasonable rates of commissions • • • and to remove impediments to and perfect the mechanism of a *free and open market;* and *are not designed* to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, *to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions,* allowances, discounts, or other charges." (Emphasis added.)

It has been noted with regard to the Maloney Act that "both the exemption language and the antitrust standards manifest a congressional intent to insulate national securities associations from the antitrust laws while the Exchange Act's regulation of the NYSE and other organized securities exchanges is devoid of either type of exempting provision." Note, *The New York Stock Exchange Minimum Commission Rate Structure: Antitrust on Wall Street,* 55 Va. L. Rev. 661, 683 (1969).

This disparity between the Maloney amendment of 1938 and the other provisions of the 1934 Act was recognized by

8. Despite these statutory provisions, at least one court has refused to imply an antitrust repealer with respect to the Maloney Act. *See, Harwell* v. *Growth Programs, Inc.,* 451 F.2d 240 (5th Cir. 1971), opinion on rehearing, 459 F.2d 461 (1972), *cert. denied,* 409 U.S. 876 (1972).

this Court in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963). The Court, holding that certain practices of securities exchanges were not exempt from the scrutiny of an antitrust court, noted that "there is nothing built into the regulatory scheme which performs the antitrust function. • • •" *Id.* at 358. The Court then noted that a different case as to antitrust exemption would be presented by a statutory scheme which provided a vehicle through which the antitrust function could be exercised. The Maloney Act was cited by the Court. *Id.* at 358, n. 12, and 360.

B. The 1934 Act's regulatory scheme is not sufficiently "pervasive" to insulate commission rate fixing from antitrust review in the courts.

A second criterion by which this Court has determined whether the Congress has intended a partial repealer of the antitrust laws in a regulatory statute is the "pervasiveness" of the regulatory scheme established. *See, e.g.,* Hale & Hale, *Competition or Control VI: Application of Antitrust Laws to Regulated Industries,* 111 U. of Pa. L. Rev. 46, 48, 57-59 (1962). In its analysis of the 1934 Act in the *Silver* case, this Court held that "the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws," and that if antitrust repealer is to be implied with respect to a specific limited area of exchange activity, it must be done on a case by case basis and only after careful analysis. 343 U.S. at 360-361.

The Exchanges and the SEC have taken the position that SEC "review" authority under §19(b) of the 1934

Act and the scheme of self-regulation suggested by §19(b) demonstrate a congressional intent to oust the courts of antitrust jurisdiction with respect to the areas of exchange activity enumerated in §19(b). However, an analysis of the statutory language of §19(b) and of the historical context in which it was promulgated demonstrates that no such result was intended by the Congress. The self-regulation, which had traditionally been exercised by the exchanges, was by no means created or enshrined by the 1934 Act; rather, the purpose of that legislation was expressly to *limit* the self-regulatory conduct of the exchanges and to control certain excessive practices to which the securities industry had proven vulnerable. As is pointed out in Comment, *An Approach for Reconciling Antitrust Law and Securities Law: The Antitrust Immunity of the Securities Industry Reconsidered,* 65 Nw. U.L. Rev. 260, 281-82 (1970):

> "Since Congress was disappointed with the performance of self-regulation in the securities industry, it used the 1934 Act to place self-regulation under governmental supervision. Professor Loss concludes that self-regulation was adopted not as a substitute for legislation and direct supervision but as a supplement to such forces."

After an analysis of the historical context of the 1934 Act, the comment concludes (pp. 283-284):

> "Congressional concern was with activities of the exchange members who had previously participated in fraudulent practices and unethical dealings rather than with activities of the exchanges as entities in themselves. This leads to the conclusion that *self-regulation was relied on to supplement government supervision of the markets for securities, but that self-regulation was not expected to have a significant role in the supervision of the market for brokerage services.*" (Emphasis added)

Clearly, the price fixing practices of the exchanges constitute a restraint on competition in "the market for brokerage services," and thus are not sanctified by a purported "mandate" of self-regulation in the 1934 Act.

Moreover, the "review" authority over exchange rule making which is conferred upon the SEC by §19(b) is confined within very narrow limits and certainly does not suggest a "pervasive" statutory scheme from which an antitrust repealer could be implied. Under the limited review provisions of §19(b), the SEC is authorized by rule or by order to "alter or supplement the rules" of any exchange, after written request to the exchange and opportunity for hearing upon the Exchange's refusal.

However "pervasive" the SEC's powers under §19(b) may be thought to be, it is clear that the SEC has exercised such powers only infrequently. As of 1971 the SEC had formally used its §19(b) authority only twice, and on only one of those occasions did it go through a full §19(b) proceeding. Note, *Informal Bargaining Process: An Analysis of the SEC's Regulation of the New York Stock Exchange,* 80 Yale L. J. 811, 815, n. 32 (1971). This is not the type of statutory scheme or agency oversight which would justify the ouster of the jurisdiction of the antitrust court.

While §19(b) does give the SEC limited review authority in the area of exchange commission rates ("reasonable rates of commission"), no mention is made in the statutory

scheme of the practice of fixing minimum commission rates. It is true, as the respondents and the SEC have argued, that the practice of fixing minimum commission rates has been employed by the New York Stock Excange since its founding in 1792. But the longevity of such practices does not shield them from antitrust scrutiny. As the Court of Appeals for the Second Circuit said in another context, "even where a defendant is successful in showing that it has followed a customary course in the industry, the first litigation of such a practice is a proper occasion for its outlawing if it is in fact in violation." *Chasins* v. *Smith, Barney & Co.*, 438 F.2d 1167, 1171 (2d Cir. 1970).

As has been demonstrated above, the chief purposes of the 1934 Act were the protection of investors from deceptive practices in the securities industry and the limitation of self-regulation by the exchanges. Given the primary concerns of Congress in drafting the 1934 Act, it is not surprising that little attention was paid to the fixing at minimum commissions. An early draft of the 1934 Act contained the phrase "uniform rate" rather than "reasonable rate," which appears in §19(b)(9) as promulgated. H. R. 7852, 73d Cong., 2d Sess. (1934). At the congressional hearings on the proposed provisions of the 1934 Act, Samuel Untermeyer, who had served as counsel in an earlier congressional investigation of stock exchanges, urged that the word "uniform" be stricken, stating: "As matters now stand, the Exchange can charge all that the traffic will bear, and that is a burden upon commerce." Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 16, at 7705 (1934). A similar sentiment was expressed in the report of the Pecora investigation, undertaken in connection with the promulgation of the 1934 Act, which concluded that "the cost to the American public of maintaining the securities market has been staggering." S. Rep. No. 1455, 73d Cong., 2d Sess., p. 6 (1934). As finally enacted, §19(b)(9) sets forth a standard of "reasonable rates of commission." In light of this legislative history, the most that can be said is that Congress intended to give the SEC a measure of control over exorbitant brokerage commission rates but to leave the practice of fixing minimum rates of commissions within the scrutiny of existing statutes and laws, including the antitrust laws.

II

Under the *Silver* doctrine, "self-regulatory" conduct of securities exchanges subject to SEC review is immune from antitrust laws only to the minimum extent necessary to make the 1934 Act work. Immunization of price-fixing schemes is not necessary to make the Act work.

A. Antitrust repealer will be implied only to minimum extent necessary.

The courts below determined that antitrust challenge to the price-fixing practices engaged in by respondents is not within the subject matter jurisdiction of the District Court since the Exchanges operate under a regime of self-regulation subject to the "review" authority of the Securities Exchange Commission pursuant to Section 19(b) of the Act, 15 U.S.C. §78s(b).

In arriving at their determination, both lower courts relied on certain elements of the analysis of this Court in

Silver v. *New York Stock Exchange,* 373 U.S. 341 (1963), the leading case setting forth the criteria to be applied in reconciling the policies of the antitrust laws and the 1934 Act. However, we submit that the approach used by the courts below omitted several of the most critical inquiries required by the doctrine of the *Silver* case, inquiries which, if pursued, may well have led to a different result.

Although this Court recognized in *Silver* that the exchanges have a duty of "self-regulation" whose dimensions are suggested by §19(b) of the 1934 Act, 15 U.S.C. §78s(b), it held unambiguously that acts or practices of the exchanges are not immunized by the 1934 Act from antitrust attack merely because they come within the rubric of "self-regulatory" conduct. A further analysis is required. The Court held that "repeal [of the antitrust laws] is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only the the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes." 373 U.S. at 357. Elaborating on this "necessity" standard for repealer, the Court further stated the principle that "[E]xchange self-regulation is to be regarded as justified in response to antitrust charges only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act * * *." *Id.* at 361.

Similarly, the determination of the courts below that the SEC has authority pursuant to §19(b)(9) of the 1934 Act, 15 U.S.C. §78s(b)(a), to "review" the commission rates fixed by the Exchanges is by no means dispositive of the issues of this case, but is merely the first step of the

comprehensive inquiry required under the doctrine of *Silver.*

It is true, as the courts below point out, that the specific exchange practices which were challenged in the *Silver* case, and which this Court held to be reviewable by an antitrust court, were not among those specifically enumerated in §19(b) of the 1934 Act, 15 U.S.C. §78s(b) as being subject to SEC "review." Seizing on this apparent distinction, both courts below found that the case at bar presented the "different case," on which the *Silver* Court reserved decision, since the challenged Exchange practices came within the purview of SEC "review" under §19(b).

In the case law interpreting the *Silver* decision, it has been established that the test of antitrust immunity of an exchange practice is not whether it falls within one of the enumerated categories of §19(b), but rather whether the "close analysis and delicate weighing process mandated by * * * *Silver*"[9] compels the conclusion that immunity is necessary.

The leading case is *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), *cert. denied* 401 U.S. 995 (1971). *Thill* involved an antitrust challenge to NYSE's "anti-rebate" rule, which prohibited its members from sharing brokerage commissions with non-members. The District Court in *Thill* concluded that the anti-rebate rule was an integral part of the commission rate structure, which was subject to SEC review under §19 of the 1934 Act and, on that ground granted defendant's mo-

9. Dissent of Mr. Chief Justice Warren to denial of certiorari in *Kaplan* v. *Lehman Brothers,* 389 U.S. 954, 957 (1967).

tion for summary judgment, holding the rule to be immune from antitrust attack. Reversing, the Court of Appeals for the Seventh Circuit held (433 F.2d at 269, 271):

> "[We] find in the teachings of *Silver*, no intimation that the mere possibility of SEC review wraps the conduct of the Exchange in an impregnable shield of antitrust immunity." (p. 269)
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> • • •
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> "• • • [E]ven the fact that the SEC may be exercising its proper supervisory power over the rules of the Exchange does not in and of itself cloak the Exchange with antitrust immunity for its conduct relating to those rules." (p. 271)

The Court of Appeals emphasized the teaching of *Silver* that "before a court may abdicate its jurisdiction on the antitrust issue the defendant must establish its anticompetitive conduct as justified because it is necessary for the operation of the Securities Act." *Id.* at 273.

The *Thill* exigesis of *Silver* was followed in the Fifth Circuit in the case of *Harwell* v. *Growth Programs, Inc.*, 451 F.2d 240 (5th Cir. 1971), *opinion on rehearing*, 459 F.2d 461 (1972), *cert. denied*, 409 U.S. 876 (1972). In *Harwell*, which involved an antitrust challenge to a rule adopted by the National Association of Securities Dealers, the Court was faced with the task of reconciling the policies of the antitrust laws and the Maloney Act. Despite the fact that the Maloney Act provides that its provisions shall prevail whenever they are in conflict with other laws, 15 U.S.C. §78o-3(n), the *Harwell* Court, following the analysis of *Silver*, held that in reconciling the statutory schemes, "the Maloney Act should be construed to reach only those things

necessary to carry out the purposes of the Act." 451 F.2d at 247. Relying on the *Thill* decision, the Fifth Circuit in *Harwell* rejected the contention that the NASD action was immune from antitrust attack merely because the NASD "acted under close supervision of the SEC." *Ibid.*

The *Thill* result and rationale was also followed in the recent opinion, in *Fredrickson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 5 CCH Trade Reg. Rep. 1974-2, Trade Cas. ¶75,227, p. 97,529 (N.D. Ill., Sept. 9, 1974), which was handed down subsequent to both of the lower court opinions below. In *Fredrickson*, which involved yet another antitrust attack on the price-fixing practices of the exchanges and their members, the Court noted that the fixing of minimum commission rates is among the areas of exchange rulemaking where the SEC may intervene and that, upon the record before the court, it appeared that the price-fixing practices of the exchanges has been "closely watched" by the SEC. Nevertheless the Court, after a lengthy discussion of the decision of the Second Circuit in the instant case, specifically rejected the reasoning of that decision. The Court, denying defendants' motion in *Fredrickson* to dismiss or in the alternative to stay the action pending reference of the matter to the SEC,[10] grounded his decision on the "necessity" standard of *Silver*, stating (at p. 97,534):

> "• • • [M]y obligation in this case is to determine if the minimum commission rates complained of are necessary to make the Securities Exchange Act of 1934 work, and to determine if these rates are being applied to the minimum extent necessary."

10. Defendants have filed a petition, still pending, for leave to appeal to the Seventh Circuit.

The Second Circuit in the present case refused to apply the above principle established by *Silver, Thill,* and their progeny in reconciling the 1934 Act with the antitrust laws. It thus rejected not only the compelling rationale of those opinions but also statements of unqualified approval of the *Thill* interpretations of *Silver* published by two congressional committees with jurisdiction over securities legislation.[11]

For example, the Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, Securities Industry Study, 92d Cong., 2d Sess. (1972) (hereinafter "House Securities Industry Study") states that the *Thill* interpretation of *Silver* "is clear and is correct, both as to what the law is and as to what the law should be" (pp. 160-161).

A similar statement of approval of the doctrine of *Silver, Thill,* and *Harwell* was expressed in the Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, Securities Industry Study (1973) at p. 227.

The Courts below specifically rejected the rationale of the *Thill* decision and failed to discuss the holding of *Harwell.* Instead, they appeared to rely primarily on the decision in *Kaplan* v. *Lehman Brothers,* 250 F. Supp. 562 (N.D. Ill. 1966), *aff'd,* 371 F.2d 409 (7th Cir. 1967), *cert. denied,* 389 U.S. 954 (1967). In *Kaplan,* exchange price fixing practices were attacked as a *per se* violation of the

11. These statements were presented to the attention of the Court of Appeals in the *Amicus* Brief of the Justice Department (Justice Br.) at pp. 16-17.

antitrust laws. As did the courts below, the *Kaplan* courts made only the preliminary determination that the exchanges had a duty of self-regulation with regard to the fixing of commission rates subject to SEC "review" under §19(b) of the 1934 Act, without proceeding further, as required by *Silver,* to consider whether the practice of fixing minimum commission rates was "necessary" to effectuate the policies of the 1934 Act.

We submit that the *Kaplan* decision was overruled *sub silentio* by the Seventh Circuit in its subsequent decision in the *Thill* case,[12] and that, in any event, the *Kaplan* result is inconsistent with the doctrine of the *Silver* case. Accordingly, to the extent that it followed the *Kaplan* decision, the decision of the Second Circuit in this case is in error.

B. Ouster of antitrust jurisdiction of the courts to pass upon the legality of Exchange price-fixing practices is not necessary to effectuate the policies of the 1934 Act.

Despite the clear guidelines set down by this Court in *Silver* and followed in several of the Circuits, neither court below directly confronted the issues of whether repeal of the antitrust laws as applied to price fixing practices in the brokerage industry was, in fact, necessary to make the 1934 Act work, or whether such repeal was the least restrictive method of reconciling the policies of the antitrust laws and the 1934 Act.

As the *Silver* decision clearly teaches, neither SEC review authority over exchange activities, nor the ex-

12. This position is taken in the House Securities Industry Study at p. 160.

changes' duty of self-regulation, gives rise to an automatic execption from the antitrust laws. 373 U.S. at 360-61. Any argument that there is necessarily an implied antitrust repealer with respect to a particular area of exchange activity is merely an affirmative defense to an antitrust action, as to which the antitrust defendant has the burden of proof. *Thill, supra,* 433 F.2d at 273; *Fredrickson, supra,* at p. 97,534. Following the *Silver* decision, the *Thill* court held that the affirmative defense of "necessity" could only be made out upon evidentiary showing of facts demonstrating such "necessity." The Court of Appeals in *Thill* held that the defendant exchange there had the burden of presenting evidence of the beneficial effects of the anticompetitive conduct complained of, evidence of the existence of provisions in the regulatory statute which performed the antitrust function, and evidence showing that the exchange rule there challenged should be preserved as necessary to make the 1934 Act work. Finding the record before it lacking in such a presentation and falling "woefully short of the meticulous analysis called for in *Silver,*" the Court of Appeals reversed the order of the lower court granting summary judgment and remanded it for further proceedings consistent with its holding. *Thill, supra,* 433 F.2d at 270.

The *Thill* result is equally appropriate in this case. The factual presentation required to sustain the affirmative defense of exchange immunity with respect to price fixing practices was not made here. Therefore, we submit, the order granting summary judgment below was improper. This Court made it clear in its decision in the *Silver* case that the determination of whether an antitrust repealer is

necessary to effectuate the policies of the 1934 Act is a determination to be made, in each particular case, by the courts and not by the regulatory agency. Referral of such questions to an agency is therefore improper. The *Silver* opinion states (p. 360),

> "[U]nder the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act."

In the *Fredrickson* case, Judge Parsons reaffirmed the role of the courts in performing antitrust analysis, stating (Trade Reg. Rep. at p. 97,534):

> "It would be an anomaly to direct the plaintiffs here to the SEC when the agency has sanctioned by its own action or inaction the alleged violation of the antitrust law. If I were to remand this case to the SEC, I would be requiring the plaintiffs to seek from the regulators an admission of their failure to properly regulate."

Judge Parsons concluded (*ibid.*):

> "This question of implied repeal is ultimately one for this court, though prior SEC deliberations are of essential assistance.
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> While it is clear that the view of the SEC regarding its experience with Exchange Commission rates may be valuable in an antitrust analysis and that some deference ought to be paid to SEC views, it is equally clear that such views are not binding on the antitrust court."[13]

13. The House Securities Industry Study notes that there is little danger of losing the benefit of SEC experience in these matters, since the courts are regularly apprised of the SEC's views through *amicus* briefs, SEC intervention, and other means. p. 160.

There is no reason to fear a conflict between the courts and the SEC on rate matters, if it is held that the courts may exercise antitrust review jurisdiction over minimum commission rates. The courts and the SEC have different areas of responsibility. As the *Thill* Court correctly stated (433 F.2d at 273):

> "* * * [Congress'] purpose in passing the Act and the primary responsibility of the SEC thereunder is to protect investors. It is in this area of public protection that the SEC claim their expertise. On the other hand, it should be remembered that the courts of the United States have over the years become the repository of antitrust expertise. Congress and our Supreme Court have directed the courts to employ this expertise unless the court in a given case concludes that its employment will frustrate the goals of the regulatory scheme."

This is not a case requiring such a conclusion.

There is no "obvious basis" for which the conclusion can be drawn that fixed minimum commission rates are necessary to make the Securities Exchange Act work. Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public,* 22 Stan. L. Rev. 675, 693 (1970). Professor Baxter, in analyzing the relationships which "cartelized" commission rates bear to the broad objectives of the 1934 Act, examined the following objectives:

(1) the promotion of broker fidelity to customers;

(2) the prevention of manipulative schemes;

(3) the protection of investors by insuring broker solvency;

(4) the facilitation of industry efficiency; and

(5) limited exchange self-regulation.

In each case, he concluded that "cartelized" commission rates were not necessary to the achievement of these objectives. We submit that Professor Baxter's analysis has a persuasive bearing on the main issue of this case.

The argument that commission rates fall within one of the areas of commission self-regulation enumerated by section 19(b) of the 1934 Act does not speak to the issue of the "necessity" of shielding Exchange practices in that area from antitrust scrutiny. The list of Exchange activities set forth in section 19(b) in no way constitutes a regime which is central to the great purposes of the 1934 Act. The §19(b) enumeration is largely a compilation of routine business practices which Congress found to be most practically regulated by permitting the exchanges in the first instance to promulgate the appropriate rules. Thus, the rule-making power of the exchanges extends not only to the "fixing or reasonable rates of commission" but to such matters as "* * * (4) hours of trading; (5) the time and method of making settlements, payments, and deliveries and of closing accounts, the minimum units of trading * * * (10) minimum deposits on margin accounts; * * * and (13) similar matters." 75 U.S.C. §78s(b). It is incredible to suggest that the Congress intended a regime such as this to oust the courts of antitrust jurisdiction.

Moreover, the actual operation of the fixed minimum commission structure of the exchanges directly contradicts the notion that price fixing is essential to the regulatory scheme under the 1934 Act. As the *Thill* Court observed in reversing an order granting summary judgment (433 F.2d at 273-274):

> "* * * [I]t is difficult to conceive how the Exchange can on remand argue that the antirebate rule is 'neces-

sary to make the Act work' when its members have gone to imaginative extremes to circumvent the rule when it serves their private economic purposes to do so."

This observation applies with equal force to the fixed minimum commission rate structure here at issue.

III

Ouster of antitrust jurisdiction will leave petitioner's class with no effective redress of its claims.

In justifying its holding that there was an implied repealer of the antitrust laws as to exchange practices encompassed within §19(b) of the 1934 Act, the Second Circuit remarked that petitioner would ultimately have access to the courts by way of a judicial review of any SEC action or order pursuant to the provisions of the Administrative Procedure Act, 5 U.S.C. §§702, 704, or under the provisions of the 1934 Act, 15 U.S.C. §78y. We respectfully submit that the decision of the Second Circuit leaves petitioner's class with at best an illusory mode of redress.

It has been said:

"The absence of formal hearing procedures and opportunities for public comment in SEC approval of NYSE rules, the limited provisions for judicial review under section 25 of the 1934 Act, and the absence of any provision for injunctive relief or treble damages, which are available under the [Sherman] Act, combine to suggest that the relief available under the 1934 Act is inadequate to provide just remedies for those injured by anticompetitive activities." (footnotes omitted)

Comment, *An Approach for Reconciling Antitrust Law and Securities Law: The Antitrust Immunity of*

the Securities Industry Reconsidered, 65 Nw. U. L. Rev. at 321.

See, also, generally, Note, *Informal Bargaining Process: An Analysis of the SEC's Regulation of the New York Stock Exchange,* 80 Yale L.J. 811.

This conclusion is borne out by the recent history of SEC practice relative to the exchange rules being challenged herein. As we have previously noted, the SEC has formally invoked its powers under §19(b) of the 1934 Act on only two occasions. When it has exercised its review powers in respect of exchange commission rates on any informal basis, the SEC has contended that such action is not reviewable by the courts and the Second Circuit has upheld this contention.[14]

It must also be taken into consideration that the regulation of claims such as are raised here to SEC jurisdiction will have the effect of discouraging future meritorious challenges of exchange anticompetitive activities.[15]

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14. See, Justice Br. (at p. 20) and Appellant's Brief to Court of Appeals (at p. 8) for their discussion of *Independent Investor Protective League* v. *SEC* (2d Cir. No. 71-1924, dismissed without opinion, January 1972).

15. The House Securities Industry Study persuasively argues:

"The Securities and Exchange Commission can, and has, litigated cases which have lasted for a considerable length of time. Thus if the Commission were given initial review power, the Subcommittee fears that a person who might otherwise seek to challenge exchange action, when dated with the enormous amount of time and money such a challenge might cost, and the difficult task of persuading the agency to reverse a previous decision, might simply not make the challenge at all. We believe that such a result would be undesirable since, as we pointed out earlier, private antitrust actions have proved to be the only effective vehicle for inhibiting or challenging exchange excesses." pp. 166-167.

Finally, the salutary effect of private antitrust challenges must be emphasized. As the District Court Judge in the *Thill* case said, the institution of an antitrust action "makes everyone move. The very fact this lawsuit is pending I am sure has had some impact on the Commission and on the Exchange and on this whole area."[16]

Conclusion

For the foregoing reasons, we submit that the Court of Appeals improperly affirmed the order of the District Court granting summary judgment. We respectfully urge that the decision of the Court of Appeals be reversed and that the case be remanded for further appropriate proceedings.

Respectfully submitted,

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No. 74-304

In the Supreme Court of the United States

OCTOBER TERM, 1974

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-304

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the court of appeals (436a)[1] is reported at 498 F. 2d 1303. The opinion of the district court is reported at 366 F. Supp. 1261.[2]

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1974. The petition for a writ of certiorari was filed on September 19, 1974, and was granted on November 18, 1974. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

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[1] References to the Appendix filed by petitioner are designated "__a."

[2] The opinion of the district court does not appear in the Appendix filed by petitioner.

QUESTION PRESENTED

The Securities Exchange Act of 1934 (the "Exchange Act") was enacted, in large measure, to provide for the regulation and control of this nation's securities markets, which were found, as noted in Section 2 of the Act, to be "affected with a national public interest" which made it "necessary to make such regulation and control reasonably complete and effective."

The comprehensive regulatory scheme of the Act placed major emphasis on the stock exchanges, which were and are the principal markets for equity securities, providing for the regulation of such exchanges, and securities transactions executed on them, in a variety of ways, including direct regulation by the Commission, and the imposition upon the exchanges of obligations to the public, as well as self-regulatory duties, to be carried out under the supervision and direction of the Commission.

The Commission will discuss the question whether that scheme of regulation, by which the Commission establishes policy for the governance of this nation's securities markets, should be superseded and disrupted by collateral antitrust suits against exchanges subject to the Commission's plenary regulatory jurisdiction, thus calling upon federal district courts to make isolated policy judgments on vital aspects of complex regulatory issues for which the Commission has responsibility.

At issue in this case is a particular, although significant, exchange practice—the fixing of commission rates —which has existed for 180 years, was recognized and subjected to Commission control by the Congress, and is now in the last stages of being phased out as a part

of an on-going major restructuring of the securities markets under Commission direction and Congressional oversight for nearly 15 years.

STATUTES INVOLVED

The pertinent provisions of the Securities Exchange Act of 1934 and the Sherman Antitrust Act are set forth in the appendix, *infra,* pp. 84-93.

STATEMENT

Petitioner, Richard A. Gordon, instituted this private antitrust action in 1971 against respondents New York Stock Exchange, Inc. ("NYSE"), American Stock Exchange, Inc. ("AMEX"), and two "representative" member firms of these securities exchanges,[3] charging that the exchanges' practice of requiring their members to charge non-members a fixed minimum commission rate for the execution of transactions on the exchange was a price-fixing conspiracy in violation of the Sherman Act, 15 U.S.C. 1 and 2 (10a). As pointed out by the Department of Justice, (DOJ Br.6) the plaintiff made other claims which are not before this Court.

The suit, which was brought by petitioner on his own behalf and on behalf of a purported class of "small investors," sought both injunctive relief and treble damages in the amount of $1.5 billion.

I. THE DISTRICT COURT DECISION

On December 4, 1973, the district court granted respondents' motion for summary judgment and en-

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[3] The two member firms named as defendants in the complaint were respondents Merrill Lynch, Pierce, Fenner & Smith, Inc., and Bache & Co., Inc. Respondents NYSE and AMEX are national securities exchanges registered as such with the Commission pursuant to Section 6(d) of the Exchange Act, 15 U.S.C. 78f(d).

tered an order dismissing the action for lack of subject matter jurisdiction. 366 F. Supp. at 1267.

The district court ruled it lacked jurisdiction to entertain petitioner's antitrust attack on the defendant exchanges' fixed rate systems because "the practices complained of are within the exclusive jurisdiction of the Securities and Exchange Commission, that the SEC, acting pursuant to Section 19(b) of the Exchange Act . . ., has been actively regulating these practices, and that, consequently, the practices are exempt from the provisions of the antitrust laws . . . ." *Id.* at 1262-1263. The court held that "the fixing of commissions falls squarely within the congressional policy of exchange self-regulation embodied in the 1934 Act" and that "the power to fix commission rates" was placed "within the exclusive jurisdiction of the Exchange, subject to Commission supervision." *Id.* The district court therefore disagreed with the decision in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (C.A. 7), *certiorari denied,* 404 U.S. 994, insofar as *Thill* has been read as holding "that an antitrust court has concurrent jurisdiction with the SEC over *all* potentially anti-competitive practices and rules . . ." of a national securities exchange. *Id.* at 1267.

II. THE COURT OF APPEALS DECISION

On petitioner's appeal, the Commission and the Antitrust Division of the Department of Justice participated *amici curiae:* the Commission supporting the trial court's judgment, the Department of Justice urging reversal.

The Court of Appeals for the Second Circuit affirmed, stating that the requisite reconciliation between the antitrust laws and the scheme of regulation embodied in the Exchange Act must begin with an analysis of this Court's decision in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (439a). It reasoned that in *Silver* the enforcement of an exchange rule was held subject to antitrust scrutiny because of the absence of Commission authority to review the particular exchange conduct involved, and that this Court acknowledged in *Silver* that "if there were Commission jurisdiction to review a challenged [exchange] rule, a different case would arise concerning antitrust exemption" (437a-438a). The court of appeals concluded that this case was that "different case," since under Section 19(b)(9) of the Exchange Act, 15 U.S.C. 78s(b)(9), supervisory authority over the fixing of commission rates is expressly vested in the Commission (440a-441a).

Finding that the exercise of antitrust jurisdiction in *Silver* was deemed proper because, in the absence of Commission jurisdiction, the assertion of judicial oversight would not result in a conflict "between agency and court" and the denial of antitrust jurisdiction "would have left no governmental body to perform the antitrust function," the court of appeals held that the existence of Commission review power supported a finding of antitrust immunity for the challenged exchange practice of fixing commission rates (441a).

The court of appeals cited additional support for its ruling concerning antitrust exemption. First, referring to the test enunciated in *Silver* that repeal of the antitrust laws is to be implied only to the extent

"necessary to make the Securities Exchange Act work," the court construed that test as necessarily contemplating a "core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws" (447a). It determined from the language of Section 19(b) of the Act, 15 U.S.C. 78s(b), that Congress had defined in that section those matters which it considered "fundamental to achieving 'the aims of the Securities Exchange Act' . . . and accorded the SEC authority to make whatever changes respecting those matters as are 'necessary or appropriate' . . . to effectuate those aims. . . ." (442a). It therefore concluded that, if a core of exchange self-regulation exempt from the antitrust laws is to have any meaning, it must necessarily "have reference to the practices enumerated in Section 19(b) and in this instance to the fixing of reasonable rates of commission" (442a). The court reasoned that if the exchanges were subjected to "duplicative or inconsistent standards announced contemporaneously by courts and Commission" with respect to matters enumerated in Section 19(b), the "inevitable consequence" would be to "render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the Exchange Act (442a).

Second, the court of appeals noted that Congress' grant to the exchanges of "unique self-regulatory power . . . was conditioned upon the creation of the SEC, invested with broad discretionary powers equal to the complex and changing nature of the problems arising in the securities industry" (443a). The court

of appeals stated: "[A]s to several specific matters inextricably linked with [the Act's purposes] . . . the Commission was empowered by Section 19(b) to order exchanges to make such amendments in their rules as the Commission found necessary to carry out the purposes of the Act" (443a). In this framework the court of appeals reasoned that the regulation of the practice of fixing commission rates, which was vested in the Commission seven years after the holding in *United States* v. *Trenton Potteries,* 273 U.S. 392, 398, that price fixing is a *per se* violation of the Sherman Act, evidenced Congress' view "that the exchange commission rate system bore crucially upon achievement of the goals of the 1934 Act" (444a).

In light of the Commission's jurisdiction to regulate exchange rate fixing and of the congressional view that exchange rate fixing was important to achievement of the Exchange Act's goals, the court below perceived "sound policy considerations governing regulation of the securities industry" which mandated "exemption from the antitrust laws with regard to fixing of minimum rates of commission" (445a). It recognized that effective regulation of this important practice would be "too hazardous with two hands on the tiller" (445a). And it emphasized that, in contrast to this Court's acknowledged inability to assess price-fixing practices under a rule of reason standard,[4] the Exchange Act "exhibits congressional confidence that the Commis-

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[4] Citing *United States* v. *Trenton Potteries, supra,* 273 U.S. at 398.

sion will be more capable of resolving problems of this nature" (450a).[5]

Finally, the court of appeals—after observing that "it would be difficult to maintain" that the effect of the rule challenged in the *Thill* case is in any significant respect different from the practice of commission rate-fixing—stated that "to the extent our decision today is inconsistent with *Thill,* we find ourselves constrained to disagree with the holding there announced" (450a-451a).

THE INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities Exchange Act of 1934 was enacted to provide "reasonably complete and effective" regulation and control of transactions in securities as . . . conducted upon securities exchange . . . markets" and of "practices and matters related thereto. . . ." Section 2 of the Act, 15 U.S.C. 78b. In establishing a scheme of regulation over the stock exchange mechanism, Congress recognized that the exchange markets were "affected with a national public interest" and constituted a principal cornerstone of the national economy. *Id.* It sought by the Act to restore and maintain investor confidence in the securities markets—confidence considered vital to the economic welfare of the country—through the enactment of provisions which would protect public investors, insure fair dealing in securities traded on exchanges and insure fair

[5] The Court below also stressed that its decision "by no means implies that Gordon at no time may have access to the courts" since judicial review of action by an administrative agency is otherwise available (451a; 498 F. 2d 1311).

administration of such exchanges. See S. Rep. No. 1455, 73d Cong., 2d Sess., p. 5; H.R. Rep. No. 1383, 73d Cong., 2d Sess., pp. 3, 5. Congress effectuated these purposes through a statutory scheme under which the Securities and Exchange Commission was vested with regulatory authority over exchange activities.

As the federal agency responsible for administering the Exchange Act, the Securities and Exchange Commission is vitally concerned that its continued ability to administer its congressional mandate and to formulate and effectuate a cohesive regulatory policy for the securities industry is not crippled through unwarranted application of antitrust standards and *ad hoc* judicial decrees affecting that regulatory program.

Resolution in this case of the question of pre-emption of the antitrust laws in favor of the Commission's jurisdiction will have a material impact upon the effective exercise by the Commission of its supervisory authority over securities exchanges, not just with respect to stock exchange commission rates, but also with respect to the entire range of exchange activities that are subject to the Commission's jurisdiction under the Exchange Act. *See, e.g., Stark* v. *New York Stock Exchange,* 346 F. Supp. 217 (S.D.N.Y.), *affirmed per curiam,* 466 F. 2d 743 (C.A. 2); *J. R. Williston & Beane* v. *Haack,* CCH Fed. Sec. L. Rep. [Current Binder] ¶94,921 (S.D.N.Y.).

INTRODUCTION AND SUMMARY OF ARGUMENT

A basic purpose of the Exchange Act is to provide for the regulation of the securities markets with particular emphasis on stock exchanges. As this Court pointed out in *Silver* v. *New York Stock Exchange Inc.,*

373 U.S. 341, stock exchanges "perform an important function in the economic life of this country" in that they serve as an indispensable mechanism through which corporate securities can be bought and sold. Prior to the enactment of the Exchange Act these markets were largely unregulated. As the exchanges grew in importance, the inadequacies of this approach and the necessity of subjecting them to a comprehensive scheme of federal regulation became more and more apparent and culminated in the enactment of the Securities Exchange Act of 1934. As this Court put it in *Silver,* 373 U.S. at 351:

> "It was, therefore, the combination of the enormous growth in the power and impact of exchanges in our economy, and their inability and unwillingness to curb abuses which had increasingly grave implications because of this growth, that moved Congress to enact the Securities Exchange Act of 1934."

The exchanges, as membership organizations, had traditionally engaged in regulating the activities of their members. The Exchange Act preserved this pattern of self-regulation, but provided to a substantial extent for supervision by the Commission. In certain crucial areas, the Congress did not rely primarily upon supervised self-regulation but either granted to the Commission direct regulatory authority, as in the case of manipulative and deceptive practices, short selling, insider trading, and other matters. In other essential areas, Congress vested in the Commission plenary authority to supervise and direct the self-regulatory activities of the exchanges through a unique scheme of

formal and informal procedures. Commission rates were in this latter category.

Since the *Silver* case involved exchange self-regulation beyond the jurisdiction of the Commission, this Court was not faced with a need to reconcile the objectives of the antitrust laws with the purposes of the Exchange Act in those areas where Congress did provide for Commission control. This Court carefully pointed out in that case, 373 U.S. at 360:

> "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented."

As the court below noted, this is that different case. (440a-441a). The exchange practice of fixing commissions, which has existed since 1792, has obvious anticompetitive implications. On the other hand, until recently this practice has been deemed significant in the functioning of the exchanges, both in attracting members to the exchanges and in contributing to bringing orders to the exchange floor for execution by the auction process. Congress recognized the existence of fixed commissions but chose neither to outlaw that practice nor to endorse it, but rather to bring it under the complete control of the Commission.

In so doing, Congress recognized that the exchanges were dynamic and changing institutions that should not be frozen into a static statutory mold. Rather, Congress chose to grant broad discretion and authority to the supervisory administrative agency—the Commission—to adapt the exchange mechanism to changing needs.

The Commission has recently concluded that the traditional exchange mechanism, including the rigid rate structure, has proved ill-suited to the needs of a changing market influenced by the rise of institutional investors and modern technology. In response to these developments, the Commission has been implementing over the last decade a major restructuring of the securities markets, including, as one of its constituent elements, the phasing out of fixed minimum commissions. This program, along with numerous other changes, is designed, among other things, to prevent the elimination of fixed commissions from having the disastrous consequences which are feared by many.

The fundamental error of the Department of Justice is that it views this case not as one involving a unique regulatory scheme for a market, but as merely another in a long line of cases concerning the application of the antitrust laws to regulated companies and public utilities. The Department would therefore make the decision in this case turn upon the presence or absence of a "pervasive scheme" of "public utility type" rate regulation. But the principles set forth in *Silver* and other decisions of this Court for the reconciliation of the unique scheme of regulation of the securities markets and the antitrust laws cannot be so simply avoided and displaced by resort to a factor which is largely irrelevant. What is relevant here is not the standards and procedures by which the Commission considers the reasonableness of a particular rate, but rather whether the plenary jurisdiction of the Commission over exchange practices such as rate fixing which significantly affect the structure and functioning of these vital markets shall be displaced and disrupted by *ad hoc* anti-

trust suits.[24] *Silver* compels a finding of implied repeal of the antitrust laws in this case, since application of the antitrust laws to exchange rules subject to Commission supervision and review would conflict with the Commission's jurisdiction and render ineffective the Exchange Act's regulatory scheme.

The wisdom of Congress' grant of exclusive jurisdiction to the Commission to regulate the nation's stock exchanges and securities markets is illustrated by the public record of Commission regulation of the fixed commission rate system. That record of Commission supervision and review—which involves formulation and implementation of Commission regulatory policies through both the formal and informal procedures contemplated by the Act—discloses the complex and subtle economic issues concerning the stock exchanges' rate systems, and substantiates the necessity for leaving the regulation of exchanges and markets to the continuing and exclusive jurisdiction of the Commission.

ARGUMENT

I. The Securities Exchange Act Established a Comprehensive Scheme of Regulation of Securities Markets in which the Securities and Exchange Commission is Vested with Jurisdiction to Engage in Continuous Regulation of all Important Matters Respecting Stock Exchanges Including the Fixing of Commission Rates.

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[24] As we point out (pp. 38-39 *infra*), a person aggrieved by Commission action with respect to exchange rules which may be anticompetitive is entitled to judicial review otherwise than by collateral attack in an antitrust court.

A close analysis of the regulatory scheme created by the Exchange Act and the proper application of the principles governing reconciliation of the Exchange Act with other statutory regimes enunciated by this Court in *Silver* v. *New York Stock Exchange, Inc., supra,* 373 U.S. 341, and *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, establish that, in order for that regulatory scheme to work, and thus for the congressional goals of the Act to be achieved, exchange conduct subject to the Commission's supervisory jurisdiction under the Act must be immunized from antitrust attack.

In *Silver* and *Ware,* as well as in other cases where the accommodation of the antitrust laws with a federal regulatory statute was to be resolved, this Court began the process of reconciliation with a searching inquiry into the genesis and aims of the federal regulatory act.[6] Thus, in order to resolve the issue of implied repeal of the antitrust laws presented in this case, we first examine the legislative history and framework of the Securities Exchange Act.

A. The Legislative History of the Act Evidences that Congress in 1934 Recognized that Securities Exchanges Possessed Anti-Competitive Features and Fashioned a Unique Scheme of Supervision by the Commission to Effect the Goals of the Act.

[6] See, *e.g., Federal Maritime Commission* v. *Seatrain Lines, Inc.,* 411 U.S. 726, 732, 736-739; *Otter Tail Power Co.* v. *United States,* 410 U.S. 366, 373-74; *Carnation Co.* v. *Pacific Westbound Conference,* 383 U.S. 213, 218-220; *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321, 350-352; *United States* v. *Radio Corporation of America,* 358 U.S. 334, 339-346.

The Exchange Act grants to the Commission broad jurisdiction to regulate the operations of the nation's securities markets. The legislative history of the Exchange Act clearly evidences that in granting this regulatory jurisdiction to the Commission, Congress intended the Commission to possess a number of regulatory tools, including supervisory authority over the regulation of stock exchange operations so that its policy-making functions would be complete and effective. One of the features of exchange operations of which Congress was specifically aware in formulating the Exchange Act and which was purposely brought within the scope of the scheme of Commission regulation under the Act was the exchanges' practice of fixing minimum rates of commission.

While Congress considered regulating stock exchanges on several occasions during the three decades prior to 1934,[7] the immediate impetus to the adoption of the Exchange Act was the disclosure of serious instances of irresponsibility displayed by exchange members during 1929 and the early thirties.[8] Early in his first administration President Franklin Roosevelt directed the formation of a committee, under the chairmanship of Daniel C. Roper, then Secretary of Commerce, to study regulation of stock exchanges.[9]

[7] See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. at 128, n. 9; *see generally* R. De Bedts, *The New Deal's SEC; The Formative Years,* Ch. 1 (1964) [hereinafter cited as *"De Bedts"*].

[8] *De Bedts,* pp. 9-29.

[9] Letter from the President of the United States to the Chairman of the Senate Committee on Banking and Currency with an Accompanying Report Relative to Stock Exchange Regulation, 73d Cong., 2d Sess., p. iii (Committee Print) [hereinafter cited as *"Roper Report"*].

The report of this committee, the *Roper Report,* specified two major imperatives that should be adhered to in any scheme for federal regulation of the stock exchanges. The report first concluded that since stock exchanges "do not present a static situation susceptible to fixed standards" but rather present "a highly dynamic, ever changing picture, subject to untold and unknown possibilities and combinations that are today unpredictable," it would be inappropriate "to place this complex and important mechanism in a strait jacket." *Roper Report,* p. 6. Therefore, the committee stated, ". . . while certain provisions [to remedy abusive practices on the exchanges] might be included in any regulations, such provisions should not be the only power of correction left open to an administrative agency [regulating exchanges], but it should have broad discretion to operate directly on various abuses as the future may prove them to exist." *Id.*

The *Roper Report* further concluded, however, that it would be undesirable to "deprive" the exchanges "of initiative and responsibility" in dealing with their members. *Id.* at p. 8. Rather, in the opinion of the committee, it appeared "distinctly better" to hold an exchange "to a high degree of accountability for the conduct of members" in order to stimulate meaningful exchange regulation of its members.

Both of these imperatives were accorded recognition in the committee's recommendation for a system of federal licensing of securities exchanges whereby

> "all exchanges desiring a Federal license must adopt and submit to the proposed Stock Exchange Authority for its approval, rules designed to comply with the regulatory requirements outlined by the proposed statute and with such rules and regulations as may be promulgated by the proposed stock exchange authority thereunder. Furthermore, as a condition of retaining a license an exchange would be required to abide by and enforce such regulatory requirements and such rules and regulations. Any exchange would be permitted to adopt any other or additional rules and regulations not inconsistent with the regulatory requirements outlined by the statute or the rules and regulations promulgated by such proposed Stock Exchange Authority." *Roper Report,* p. 11.

Following publication of the *Roper Report,* legislation [10] was introduced in both the House and Senate,[11] which provided for the licensing and disciplining of securities exchanges, and vested broad discretionary authority in the regulatory agency over, in effect, the entire range of exchange operations (Doc. App. 1-8).[12] This grant of broad authority to the federal

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[10] For a description of the history of the drafting of the Exchange Act, see *De Bedts,* Ch. III.

[11] The Exchange Act was originally introduced as H.R. 7852, 73d Cong., 2d Sess. and S. 2693, 73d Cong., 2d Sess. Following extensive hearings, these bills were revised and reintroduced as H.R. 8720, 73d Cong., 2d Sess., H.R. 9323, 73d Cong., 2d Sess. and S. 3420, 73d Cong., 2d Sess. In amended form, H.R. 9323 and S. 3420 became the Securities Exchange Act.

[12] See H.R. 7852 and S. 2693, Sections 5 and 18(c); H.R. 8720, Sections 5 and 18. Pertinent sections of these bills, as well as other relevant publicly-available materials are set forth in the Documentary Appendix accompanying this brief. References to mate-

regulating agency contained in the early drafts of the legislation, received both support [13] and criticism [14] during the congressional hearings held on these bills. The principal criticism raised was that these bills would impose greater federal regulation of the exchanges than had been contemplated in the *Roper Report,* providing for what one critic characterized as "not regulation but domination." [15] In fact, the drafters of the legislation acknowledged that they had struck a different balance with respect to the extent the federal agency would be empowered to take the regulatory initiative than had the *Roper Report,*[16] since the bills would give the Commission power "to step in and prescribe the rules under which the exchange shall operate in practically all particulars . . . ." [17] This regulatory scheme was justified, it was argued, on the ground that it was

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rial contained in the Documentary Appendix are cited as ("Doc. App. ").

[13] See Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.), 73d Cong., 1st and 2d Sess. [hereinafter cited as "Senate Hearings"], pp. 6868 (Statement of Herman Kinnicutt, member of Investment Bankers Association, New York, N.Y.), 7256 (Statement of A. Verle Shaw).

[14] See Hearing before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. [hereinafter cited as "House Hearings"], p. 227 (Statement of Richard Whitney, President of the New York Stock Exchange); Senate Hearings, pp. 6638-39 (Statement of Richard Whitney, President of the New York Stock Exchange), 6901-6915 (Statement of Frank R. Hope, President of the Association of Stock Exchange Firms).

[15] See Senate Hearings, pp. 6638-39; House Hearings, p. 227.

[16] See House Hearings, pp. 26-27 (Statement of Hon. H. M. Landis, Commissioner, Federal Trade Commission).

[17] Senate Hearings, p. 6566 (Statement of Thomas G. Corcoran).

necessary to empower the Commission to step in, in the event the Commission finds the method of operation being undertaken by the exchange unsatisfactory to it and to this end the Commission should have a power of intervention short of revoking an exchange's license.[18]

It was in this context—a debate on the proper balance that ought to be struck—that the Congress specifically focused on the fact that the stock exchanges had anti-competitive features and that any federal regulation of the exchanges should involve regulation of these features, including in particular, the exchanges' practices of fixing minimum commission rates. Thus, the practice of fixing minimum commission rates was described in the congressional hearings,[19] and the ap-

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[18] Senate Hearings, pp. 6566-6570 (Statement of Thomas G. Corcoran).

[19] See Senate Hearings, pp. 6075, 6080; House Hearings, pp. 320-321, 423.

The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792. *See* Eames, The New York Stock Exchange, p. 14 (1894).

In 1912 and 1913, a subcommittee of the House Committee on Banking and Currency, 62d Congress, made an extensive investigation of stock exchange operations. The resulting report of this committee—H.R. Rep. No. 1593, 62d Cong., 3d Sess., known as the *Pujo Report* after the Chairman of the subcommittee—specifically dealt with the NYSE's practice of commission rate fixing, noting that:

> "The rule is rigidly enforced by suspension from one to five years for a first violation and expulsion for a second. . . . The acknowledged object is to prevent competition amongst the members."

Pujo Report, p. 39. The *Pujo Report* advised against any congressional action proscribing this practice because, *inter alia,* the subcommittee believed

propriateness of federal regulation of the exchanges' fixed rate system was the subject of discussion during those hearings.[20] For example, one of the leading authorities of the time on stock exchange operations,

"the present rates to be reasonable, except as to stocks, say, of $25 or less in value, and that *the exchange should be protected* in this respect . . . *against a kind of competition between members that would lower the service and threaten the responsibility of members. A very low or competitive commission rate would also promote speculation and destroy the value of membership.*"

Pujo Report, pp. 115-116 (emphasis added).

The conventional wisdom concerning the propriety of the fixed commission rate system was the same at the time of the enactment of the Securities Exchange Act. Thus, a comprehensive study of the operations of the exchange market published in 1935 made the following observation with respect to the fixed rate system:

"Among the provisions [of the NYSE's rules and constitution] specifically regulating the brokers in their relations with each other, there is the requirement of *minimum commission charges. This serves the double purpose of making unfair competition among brokers punishable and of providing better and cheaper service to the public.* The prohibition against splitting commissions has served to do away, in part at least, with unnecessary middlemen who are beyond the control of the Exchange. It has also kept the larger part of the brokerage business in the hands of the brokers rather than permitting it to drift into the hands of banks."

The Twentieth Century Fund, Inc., *The Security Markets*, p. 226 (1935) (emphasis added).

An earlier publication of the Twentieth Century Fund's findings, Twentieth Century Fund, *Stock Market Control* (1934), was repeatedly relied upon in the drafting and consideration of the Securities Exchange Act. See, *e.g.*, Senate Hearings, p. 6467; 78 Cong. Rec. 8031-8032 (remarks of Mr. Pettengill), 8180 (remarks of Senator Fletcher), 8395 (remarks of Senator Barkley).

[20] *Compare* Senate Hearings, p. 6868 (where the witness recommended against giving the federal regulatory agency "control over commission charges" on the ground that such control "must be left as [a matter] of self-preservation to the exchanges and their members") *with id.*, p. 7705.

Samuel Untermeyer, who was chief counsel to the Congressional committee which wrote the *Pujo Report* (discussed note 19 *supra*) made the following recommendations with respect to stock exchange rate fixing:

"While section . . . [18] of your bill [S. 2693] would give the . . . Commission the right to prescribe uniform rates of commission, it does not otherwise authorize the Commission to fix rates, which it seems to me it should do and would do by striking out the word 'uniform.' *That would permit the Commission to fix rates.*

"The volume of the business transacted on the exchange has increased manyfold. Great fortunes have been made by brokers through this monopoly. The public has no access to the exchange by way of membership except by buying a seat and paying a very large sum for it. Therefore it is a monopoly. Probably it has to be something of a monopoly. But after all it is essentially a public institution. It is the greatest financial agency in the world, and should be not only controlled by the public but *it seems to me its membership and the commission charged should either be fixed by some governmental authority or be supervised by such authority.* As matters now stand the exchange can charge all that the traffic will bear, and that is a burden upon commerce."

Senate Hearings, p. 7705 (emphasis added). The bill as enacted deleted the word "uniform" as Mr. Untermeyer suggested, and substituted the word "reasona-

ble." *See,* H.R. Rep. 1838, 73d Cong., 2d Sess., p. 19 (Conference Report).

The original bills were revised in response to the criticisms and suggestions made in the hearings so that the legislation, as reported out of the respective House and Senate committees,[21] struck a balance somewhat more akin to the position expressed in the *Roper Report* than was the position contained in the initial version of the bills by leaving with the exchanges in the first instance the responsibility to establish rules governing their operations but nevertheless subjecting the exchanges to the continuous authority of a federal regulatory agency.

Nevertheless, Congress emphasized that this grant of self-regulatory responsibility was to be subject to the continuous plenary jurisdiction of the Commission. As the House report explained, "the bill gives the Commission broad powers over the exchanges to insure their efficient and honest functioning" because as economic forces affecting speculation converge "upon the exchanges, the control of the exchange mechanism is a necessary part of any effective regulation." H.R. Rep. 1383, *supra,* at p. 14.[22] To aid these powers, exchanges seeking registration were required to agree that they would continuously furnish "the

[21] H.R. 9323, 73d Cong., 2d Sess. and S. 3420, 73d Cong., 2d Sess.

[22] One of the basic purposes of the Exchange Act was the establishment of "an efficient, adequate, open and free market for the purchase and sale of securities. . . ." (78 Cong. Rec. 8162 (remarks of Senator Fletcher)) and control of the exchange mechanism was regarded as essential to achieving that purpose. See 78 Cong. Rec. 7862 (remarks of Mr. Lea), 7864 (remarks of Mr. Wolverton), 8161, 8163 (remarks of Senator Fletcher).

Commission with complete information concerning [their] . . . organization, membership, and rules." S. Rep. No. 792, 73d Cong, 2d Sess., p. 15. And, as the House Report further explained, "if the rules of the exchange in *any important matter* are not appropriate to insure fair dealing, [the Commission is empowered] to order such changes in the rules after due notice and hearings, as it may deem necessary." H.R. Rep. No. 1383, *supra,* at p. 15 (emphasis added).

The sponsors of the legislation pointed out that it was necessary throughout the bill to vest "broad discretionary powers" in the Commission because of the "complicated nature of the problems" dealt with in the bill, and because the bill regulated a "field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means." H.R. Rep. No. 1383, *supra,* at pp. 6-7. And the powers specifically granted the Commission over exchange rules were characterized as "quasi-legislative."[23]

The floor debates on H.R. 9323 and S. 3420 focused on the nature and consequences of the broad supervisory power that these bills would, if enacted, grant the Commission over the exchanges' rules. In the House, concern centered around what is now Section 19(b) of the Act (then Section 18(b), H.R. 9323), which empowered the Commission to act by rulemaking to amend or alter the rules of an exchange, and the fact that the bill did not provide for direct appellate review of such Commission action. 78 Cong. Rec.

[23] 78 Cong. Rec. 8091 (remarks of Mr. Lea); see also 78 Cong. Rec. 7696 (remarks of Mr. Rayburn), 7862 (remarks of Mr. Lea).

8087-8093. In arguing that a procedure should have been provided for judicial review of Commission action altering or amending exchange rules, certain members of the House stressed, among other things, that the bill as drafted gave the Commission unreviewable authority to fix commission rates at levels which could, for example, be set so low as to put exchange members out of business.[24]

During debate in the Senate, the bill was criticized as granting the Commission authority over exchanges that exceeded that necessary to achieve what some Senators perceived as the bill's underlying purpose of curbing dishonest and economically harmful manipulative and speculative practices in connection with trading in securities.[25] An amendment was offered by Senator Hastings of Delaware on the Senate floor to what is now Section 19(b) of the Exchange Act, that would have struck from that section of the bill the enumerated matters presently subject to the Commission's jurisdiction under Section 19(b), and instead would have limited the Commission, by order, to alter or supplement the rules of an exchange to prevent "excessive credit for speculation and . . . unfair practices on stock exchanges." 78 Cong. Rec. 8592. Senator Hastings explained that in his view Section 19(b) went too far in empowering the Commission "to regulate the internal operations of exchanges in many matters which do not bear, either directly or even remotely

[24] See 78 Cong. Rec. 8091 (remarks of Mr. Pettengill and Mr. Wadsworth), 8092 (remarks of Mr. Dondero).

[25] See 78 Cong. Rec. 8283 (remarks of Senator Walcott), 8591-92 (remarks of Senators Hastings and Copeland).

upon the control of credit or unfair practices in the purchase and sale of securities." 78 Cong. Rec. 8592. One of the matters of internal operations specifically pointed to was the fixing of commission rates.[26] *Id.*

In support of the Hastings amendment, Senator Copeland of New York argued that "the brokerage business is not a public utility" and therefore that it would be inappropriate to regulate the exchanges like a public utility through the fixing of commission rates. *Id.* Because of a "determination" in the Congress "to turn over the stock exchange and its whole operation to a commission of the Federal Government," Senator Hastings predicted that the amendment would not be adopted and, in fact, the amendment was rejected. *Id.*

While various provisions of the legislation were modified in some respects prior to passage of the Act,[27] the basic regulatory scheme described above was enacted.

In view of the foregoing discussion, we fail to understand how the Department of Justice [28] can contend that

[26] Similarly, Senator Hastings had previously observed during the floor debates that

> "there is the distinct and definite provision that the proposed commission may fix the rates of commission which the stock exchange members may charge for the services they render. They cannot by rule and regulation govern it any longer. They cannot by rule and regulation fix it at an amount which they believe will return to them a fair amount of money annually, or that will increase their business. They may not use their judgment about it any longer. It passes to the commission." 78 Cong. Rec. 8490.

[27] See, *e.g.*, H.R. Rep. 1838, *supra*, at p. 37.

[28] References to pages of the Brief for the United States As Amicus Curiae, which has been filed by the Solicitor General on

Mr. Untermeyer's testimony was the "only reference to fixed commission rates of any significance" in the legislative history of the Exchange Act (DOJ Br. 30) and that there is "nothing in the history . . . [of the Exchange Act that] reflects a purpose by Congress to endorse" the practice of fixing minimum commission rates (DOJ Br. 53). The legislative history, as the court below noted (451a), clearly reveals that Congress in 1934 viewed the fixed rate practice as a "keystone" of the exchanges' organization. Moreover, there is further exhibited in the Exchange Act's history the deliberate determination by the Congress not to leave unregulated the anti-competitive aspects of exchange operations, but rather to subject all important matters, including the practice of exchange rate-fixing, to the jurisdiction of the Commission. Thus, Congress adopted Mr. Untermeyer's recommendation to provide the Commission with plenary authority over the exchange's anti-competitive practice of fixing rates (see pp. 21-22, *supra*). And it did so in the context of the apparent endorsement of the exchanges' rate fixing practices by the Pujo Committee, to which Mr. Untermeyer was chief counsel, and in the context of the conventional wisdom in 1934 that such practices were desirable.[29] In addition, in rejecting the Hastings amendment, (see pp. 24-25, *supra*), Congress manifested its intention that the authority granted to the Commission in Section 19(b) to alter or supplement ex-

behalf of the Department of Justice, are cited as "DOJ Br. . . . ." Arguments set forth in that brief are referred to as those of "the Department of Justice."

[29] See note 19 *supra*.

change rules, where "such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange," should go beyond the mere prevention of fraudulent and manipulative practices on the exchanges and should authorize the Commission to supervise the exchange mechanism with respect to all important matters—including the fixing of commission rates.[30]

The conclusion drawn from the Exchange Act's history, that Congress intended to superimpose a scheme of regulation over entities it knew to have anti-competitive features, is in no way mitigated by amendments to the Exchange Act in 1936 and 1938, as the Department of Justice asserts (DOJ Br. 32-35). Thus, while the 74th Congress in 1936 did amend the Exchange Act by adding Section 12(f) to the Act, 15 U.S.C. 78l(f), to permit trading of unlisted securities on exchanges and thereby "create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets" (S. Rep. No. 1739, 74th Cong., 2d Sess., p. 3), Congress specifically

[30] The Department of Justice appears to have abandoned its essentially unsupported assertion advanced in the court below that the power of the Commission in Section 19(b)(9) was intended to be limited solely to setting maximum commission rates in order to protect investors from exhorbitant charges. Brief for the United States as Amicus Curiae, *Gordon* v. *New York Stock Exchange*, C.A. 2, No. 74-1043, at p. 26. Certainly, in view of the exchanges' practice of fixing minimum commission rates, dating back to 1792, an intention to exclude fixed *minimum* commissions from the Commission's supervisory jurisdiction would have been expressed in clear and unequivocal terms.

explained that the purpose of the amendment was "to allow each type of market to develop in accordance with its natural genius and consistently with the public interest." *Id.* This reference to the "natural genius" of each type of market reflects Congress' awareness of the distinction between the competitive over-the-counter market on the one hand and the exchange markets which it had subjected to regulation in 1934.

Congress' awareness of this distinction is more clearly revealed in connection with the 1938 Maloney Act Amendments to the Exchange Act which, contrary to the Department of Justice's contentions, do not support the view that Congress intended the antitrust laws to apply to exchange practices subject to the Commission's jurisdiction (DOJ Br. 35). The Maloney Act provided for self-regulation of the over-the-counter market through the establishment of associations of over-the-counter market dealers—associations not yet in existence when the Act was passed. In creating this regulatory scheme, Congress recognized that self-regulatory associations could have an anti-competitive effect on the then existing "free and open" nature of the over-the-counter market. H.R. Rep. No. 2307, 75th Cong., 3d Sess., p. 8. The proponents of the Maloney Act noted that, in contrast to the over-the-counter market, stock exchanges "had certain features that may be regarded as monopolistic because of their exclusive nature," and explained that the Exchange Act represented "an attempt to bring those practices under control." Hearings before the Senate Committee on Banking and Currency on S. 3255, 75th Cong., 3d Sess., p. 7. Since the over-the-counter market lacked any

anti-competitive aspects, Congress made clear in the Maloney Act that the activities of registered associations were "to be consistent with the operation of free and open markets." H.R. Rep. No. 2307, *supra,* at p. 8. But the Exchange Act did not attempt to turn stock exchanges into free and open markets; rather it sanctioned the anti-competitive features of the exchange markets subject to the Commission's jurisdiction.

Finally, the Department of Justice refers to the enactment by Congress in 1934 of the Communications Act which provided an express antitrust exemption for telephone company mergers approved by the Federal Communications Commission (DOJ Br. 31, n.17). It is contended that the inclusion of this express exemption in that act, which was being considered about the same time as the Exchange Act, compels the conclusion that the absence of an express exemption in the Exchange Act requires application of the antitrust laws to matters subject to the Commission's jurisdiction under Section 19(b). But, as the Department of Justice itself has asserted (DOJ Br. 47-48), it is likely that Congress in 1934 did not think that the Sherman Act applied to exchange practices, and thus would have had no reason to provide for an express exemption. Also unfounded is the alternative assertion that, because Congress did not expressly consider the antitrust laws when formulating the Exchange Act, this Court cannot now find an implied repeal of those laws with respect to matters subject to the Commission's jurisdiction. The existence of antitrust immunity is not dependent upon whether Congress specifically intended to exempt exchange practices subject to Com-

mission jurisdiction from antitrust attack. Indeed, if as the Department of Justice asserts (DOJ Br. 47), the question of implied repeal depends simply on finding a conscious congressional intention to exempt regulated activity from the antitrust laws, it is difficult to understand why this Court has on so many occasions engaged in exhaustive analyses of other regulatory schemes in determining whether to find an implied repeal. See *Georgia* v. *Pennsylvania R.R. Co.*, 324 U.S. 439; *United States* v. *Radio Corporation of America*, 358 U.S. 334; *California* v. *Federal Power Commission*, 369 U.S. 482; *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296; *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321; *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213; *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 237; *Otter Tail Power Co.* v. *United States*, 410 U.S. 366. As we shall show *infra*, implied repeal of the antitrust laws arises here because the statutory scheme in the Exchange Act simply will not work as Congress intended if exchange conduct subject to the Commission's jurisdiction may be challenged under the antitrust laws.

B. The Exchange Act on Its Face Confers Jurisdiction on the Commission to Regulate Stock Exchanges With Respect to all Important Matters.

The Commission was given responsibilities under the Exchange Act with respect to numerous activities affecting securities markets. Thus the Commission is empowered to define and prohibit such matters as manipulation and deceptive practices (see Sections 9 and 10 of the Act, 15 U.S.C. 78i and 78j); to require

brokers and dealers to meet adequate financial standards (see Sections 8 and 15(c)(3) of the Act, 15 U.S.C. 78h and 78o(c)(3)); to set standards for the utilization of exchange membership; and to regulate exchange specialists and floor traders (see Section 11 of the Act, 15 U.S.C. 78k). Further to implement the Commission's regulation of exchanges, Congress also provided in Section 6 of the Act, 15 U.S.C. 78f, for the registration of securities exchanges with the Commission.[31] Section 6(a), 15 U.S.C. 78f(a), provides, as a prerequisite to registration, that the registration statement filed by the exchange contain, *inter alia*, "[a]n agreement . . . to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of" the Exchange Act and the Commission's rules and regulations thereunder. Furthermore, under Section 6(d), 15 U.S.C. 78f(d), the Commission, before granting an application for registration, must find that an exchange is "so organized as to be able to comply with the provisions of" the Act and that its rules "are just and adequate to insure fair dealing and to protect investors."

Congress next provided, through Section 19(a) of the Act, 15 U.S.C. 78s(a), that the Commission be vested with jurisdiction to assure compliance by registered exchanges with their duties under the Act. Section 19(a)(1), 15 U.S.C. 78s(a)(1), authorizes the Commission to discipline an exchange within specified limits for violating the Act or any rules thereunder, or

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[31] Section 5 of the Act, 15 U.S.C. 78e, makes it unlawful, except in certain cases not relevant here, to effect any securities transaction on an unregistered exchange.

for failing "to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon."[32] And pursuant to Section 19(a)(2), 15 U.S.C. 78s(a)(2), the Commission may discipline members and officers of registered exchanges.

Finally, and most important, in Section 19(b) of the Act Congress conferred plenary powers upon the Commission to supervise and oversee the nature and structure of particular exchanges and exchanges generally. Under Section 19(b), if the Commission, after following prescribed procedures, determines that changes in an exchange's rules are

> "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange [it may] by rules or regulations or by order . . . alter or supplement the rules of such exchange"

with respect to "such matters as" twelve broadly enumerated subjects and "similar matters." One of the matters *specifically* enumerated—in Section 19(b)(9)

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[32] The Commission has, pursuant to Section 19(a)(1), withdrawn the registration of a national securities exchange which, among other things, violated the Exchange Act and failed to enforce compliance with the Act and with the exchange's own rules by members and issuers of listed securities. *San Francisco Mining Exchange*, Securities Exchange Act Release No. 7870 (1966), [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77,343, *affirmed sub. nom. San Francisco Mining Exchange* v. *Securities and Exchange Commission*, 278 F. 2d 162 (C.A. 9).

—is "the fixing of reasonable rates of commission. . . ."[33]

The procedures prescribed in Section 19(b) that are to be followed in effecting changes in exchange rules relating to rates of commission, have been aptly summarized as follows:

> "The first step is that an exchange adopts rules fixing rates of commission. If changes are deemed necessary or appropriate, the Commission is to present an appropriate request in writing for specified changes. Compliance by the exchange presumably ends the matter, but if the exchange does not accede, the Commission is empowered, after appropriate notice and opportunity for hearing, 'by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) . . .'"[34]

In order to supplement its Section 19(b) authority to regulate the rules of registered securities exchanges

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[33] Congress' inclusion of rate-fixing in Section 19(b)(9) is consistent with another indicium of Congress' intent to fashion Commission regulation of exchanges around their essentially anticompetitive practices. Thus, Section 3(a)(3) of the Act defines an exchange member as

> "any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with payment of a commission or fee which is less than that charged the general public. . . ."

[34] Securities and Exchange Commission, *Special Study of Securities Markets*, Pt. 2, p. 344 (1963), H. Doc. No. 95, 88th Cong., 1st Sess.

and because that authority would be fostered by affording "an opportunity for orderly Commission consideration of exchange rules before they become effective," the Commission in 1964 promulgated Rule 17a-8, 17 C.F.R. 240.17a-8, pursuant to Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), which requires regulated entities to file reports. See Securities Exchange Act Release No. 7253 (1964). The Rule requires an exchange to file with the Commission "copies of . . . any proposed amendment or repeal of, or any addition to, its rules not less than three weeks . . . before any action is taken [by the exchange to adopt] . . . such amendment."

It can therefore be seen that the Exchange Act contemplates Commission supervision of exchange self-regulation through a process having both formal and informal aspects. Thus, the procedure set forth in Section 19(b), which authorizes the Commission to present a written request to an exchange to effect changes in its rules, as well as the procedure set forth in Rule 17a-8, affording the Commission an opportunity to examine proposed rule changes prior to their adoption, results in continuous Commission participation in the process of formulating exchange rules and amendments to exchange rules *without* the institution of a formal rulemaking or adjudicatory proceeding pursuant to Section 19(b).[35] In this process the Commission necessarily exercises its statutory mandate to insure that the exchange's rules are consistent with

[35] The Commission's authority is further supplemented by its power to conduct public investigatory hearings pursuant to Section 21(a), 15 U.S.C. 78u(a).

the purposes of the Act. This is precisely the way in which Congress desired the "partnership between government and private enterprise that marks the design of the . . . Exchange Act . . ." to operate. *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 366.

It is also evident that, commencing from the initial stage of registration of an exchange with the Commission, the necessity and propriety of exchange rules regarding the matters enumerated in Section 19(b), including the fixing of commission rates, are subject to the continuous jurisdiction of the Commission. And while

> "the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance." [36]

any exchange's action affecting its commission rate structure is also a matter which must comport with Commission policy.

Under the public interest standard in Section 19(b), the Commission has for over three decades recognized that the national policy favoring competition is a highly relevant factor in determining whether rules of an exchange are "necessary or appropriate." [37] Furthermore, the standard governing the Commission's

[36] Securities Exchange Act Release No. 10560 (1973), CCH Fed. Sec. L. Rep. ¶79,603 at p. 83,620.

[37] See, *e.g., In the Matter of the Rules of the New York Stock Exchange,* 10 SEC 270, 287; Securities Exchange Act Release No. 8234 (January 26, 1968); Securities Exchange Act Release No. 9950 at pp. 169-70 (January 26, 1973) [185 BNA Sec. Reg. and

actions under Section 6(d) of the Act in ordering effective an exchange's registration involves the same public interest test found in Section 19(b) and therefore, contrary to the view of the Department of Justice (DOJ Br. 42), also requires Commission consideration of competitive factors.

Indeed, in the Commission's most recent public proceeding involving the registration of a national securities exchange—the Chicago Board Options Exchange [38] —under Section 6, the Antitrust Division of the Department of Justice was an active participant in the Commission's proceeding and urged that "it would be plainly contrary to the broad public interest in a competitive economy" for the Commission to permit the Chicago Board Options Exchange to have a fixed minimum commission rate system.[39] The Commission did in fact consider competitive factors in determining to order effective the Chicago Board Options Exchange's rules.[40]

L. Rep. (January 17, 1973)]. In *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 364, n.16, this Court stated that an exchange rule adopted at the direction of the Commission pursuant to Section 19(b) would have to be "consonant with the antitrust laws." See also *Bowman* v. *Arkansas-Best Freight System, Inc.*, 95 S. Ct. 438, 448; *Gulf States Utilities* v. *Federal Power Commission,* 411 U.S. 747; *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra,* 411 U.S. 726.

[38] See *Chicago Board Options Exchange, Inc.,* Securities Exchange Act Release No. 9985 (February 1, 1973), CCH Fed. Sec. L. Rep. ¶79,212 at p. 82,669.

[39] See Comments of the United States Department of Justice, Proposed Rules of the Chicago Board Options Exchange, Securities and Exchange Commission File No. 10-54-1 (January 15, 1973), p. 4. (Doc. App. 162, 165).

[40] See *Chicago Board Options Exchange, Inc.,* Securities Exchange Act Release No. 9985, *supra,* CCH Fed. Sec. L. Rep. ¶79,212 at p. 82,671.

However, competition is not the sole factor the Commission must consider in regulating exchange rules. The scheme of regulation in the Exchange Act is the "frame of reference within which the Commission operates; and the policy expressed in [that Act] must be the basic determinant of its action." [41] Accordingly, along with the national policy favoring competition, the Commission must also be concerned with such questions as the liquidity of the exchange markets, the ability of the brokerage industry to raise capital for industry and to provide efficient and effective service to investors.[42]

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[41] *McLean Trucking Co.* v. *United States,* 321 U.S. 67, 79-80, 85-88 (Interstate Commerce Commission); *Bowman* v. *Arkansas Best Freight System, Inc., supra,* 95 S. Ct. at 448; *cf., California Gas Producers Association* v. *Federal Power Commission,* 421 F. 2d 422, 428-29 (C.A. 9), *certiorari denied,* 400 U.S. 819; *City of Statesville* v. *Atomic Energy Commission,* 441 F. 2d 962, 987 (C.A. D.C.) (Leventhal J., concurring); *Northern Natural Gas Co.* v. *Federal Power Commission,* 399 F. 2d 953, 961 (C.A. D.C.). The legislative history of the Exchange Act suggests that Congress intended that the Commission, in exercising its Section 19(b) authority over exchanges, look to the policies of the Act generally for a standard. See 78 Cong. Rec. 8091 (remarks of Mr. Lea).

[42] Recognition of the need to balance these competing policy considerations has motivated the congressional committees' studying the securities industry's rate structure to endorse the Commission's program for a phased elimination of fixed rates. See *Regulation of Securities Trading by Members of National Securities Exchanges and the Sale of Investment Advisers of Registered Investment Companies, A Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 470,* Sen. Doc. No. 93-187, 93d Cong., 1st Sess., at 3 (1973); *Report of the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, Securities Industry Study,* 93d Cong. 1st Sess. (February 1, 1973) at 62. See also Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3169, 92d Cong., 2d Sess., pp. 8, 11, 14 (Testimony of William J. Casey, Chairman, Securities and Exchange Commission).

Thus, to the extent that changes in an exchange's rules, including modification of the commission rate structure of an exchange, may affect the ability of the exchange to operate, the Commission must weigh the continued viability of the exchanges against a policy considering competition alone. Commission consideration of these factors has been most recently illustrated in the Commission's adoption of Rule 19b-3, 17 CFR 19b-3, which prohibits the fixing of commission rates by exchanges after certain dates."

The Commission's continuing jurisdiction to supervise exchange rules and practices with respect to the matters enumerated in Section 19(b) and the fact that the Commission weighs the national policy favoring competition in its administration of its mandate to supervise exchange rules and practice demonstrates that Congress intended the Commission's jurisdiction over the matters enumerated in Section 19(b) to perform the "antitrust function." "

Moreover, as the court of appeals recognized (451a; 448 F. 2d at 1311), implied repeal of the antitrust laws does not preclude a sufficiently-aggrieved person from challenging exchange rules which may be anti-competitive."

" See Securities Exchange Act Release No. 11203 (January 23, 1975); see also pp. 75-80, *infra*.

" *Silver* v. *New York Stock Exchange, supra*, 373 U.S. at 358; see also *Kaplan* v. *Lehman Brothers*, 389 U.S. 954, 956 (Warren, C. J., dissenting from denial of certiorari); *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, 302, n.13.

" Appropriate judicial review is not by way of collateral attack on exchange rules maintained under Commission supervision, but rather through direct judicial review of Commission action with respect to the exercise of its supervisory responsibility. The judicial check on Commission action is afforded by the fact that Commission orders promulgated under Sections 6 and 19(b) are reviewable in a court of appeals pursuant to Section 25(a) of the Act, 15 U.S.C. 78j(a). And, Commission rules adopted under Section 19(b), as well as informal exercises of the Commission's supervisory authority, such as a determination not to object to the adoption of a proposed rule, have been held to involve "agency action" which, under appropriate circumstances, is reviewable in a district court. *See Independent Broker-Dealers' Trade Association* v. *Securities and Exchange Commission* 442 F.2d 132, 141-143, *certiorari denied*, 404 U.S. 482; *cf.*, *PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission*, 485 F.2d 718, 726, 733 (C.A. 3), *certiorari denied*, 416 U.S. 964. *See generally* Sections 4(d), 10(a) and 10(d) of the Administrative Procedure Act, 5 U.S.C. 553(e), 702(a), (d). Thus, it cannot be said that implied repeal of the antitrust laws in this area would leave the Commission with unreviewable authority over exchange rules.

" *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra*, 414 U.S. at 125.

II. Application of the Antitrust Laws to Exchange Conduct Subject To Commission Jurisdiction Would Be Repugnant to the Scheme of Regulation Established By the Exchange Act.

A. Silver and Ware Require a Determination in the First Instance of Whether the Exchange Act's Regulatory Scheme Will Work if Antitrust Laws Are Applied To Exchange Activity Subject To Commission Jurisdiction Under Section 19(b).

With the framework and goals of the Exchange Act presented, it is now appropriate to consider "the principles of stock exchange pre-emption delineated" " by this Court in *Silver* v. *New York Stock Exchange, Inc., supra,* 373 U.S. 341, and *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. 117.

In *Silver,* the petitioners, who were not members of the NYSE, brought an action under the Sherman Act alleging that the NYSE "conspired with its member firms to deprive petitioners of their private wire connections and stock ticker service" provided to them by members of the NYSE. 373 U.S. at 345. This Court initially noted that since the NYSE's action, in causing member firms to disconnect petitioners' wire connections and stock ticker, constituted a group boycott, "absent any justification derived from the policy of another statute or otherwise, the Exchange acted in violation of the Sherman Act." *Id.* at 347-349. Because the NYSE had taken action under color of enforcing "its rules governing members' transactions and relationships with non-members," purportedly "germane to performance of . . . [its] duty" of self-regulation embodied in the Exchange Act (*id.* at 356), the existence of a *prima facie* violation of the antitrust laws was found by the Court to be only "the beginning, not the end, of inquiry." *Id.* at 349. As this Court stated, the "antitrust aim of eliminating restraints on competition" must be reconciled "with the effective operation of a public policy [embodied in the Exchange Act] contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." *Id.*

In effecting this reconciliation between the public policy of the Exchange Act and the aims of the antitrust laws, this Court enunciated the "guiding principle" that, since the Exchange Act "contains no express exemption of the antitrust laws," and since

"'[i]t is a cardinal principle of construction that repeals by implication are not favored,'" an implied repeal would be found "only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." *Id.* at 357. This Court then distinguished between two aspects of the self-regulatory scheme embodied in the Exchange Act: those self-regulatory activities of registered exchanges over which the Commission has jurisdiction; and those self-regulatory activities which are not within the Commission's jurisdiction. *Id.* In this regard, the Court observed that while the Commission has the "power to request exchanges to make changes in their rules" and "to disapprove any rules adopted by an exchange," it does not have "jurisdiction to review particular instances of enforcement of exchange rules." 373 U.S. at 357. Accordingly, the particular exchange action before this Court in *Silver* was believed by the Court not to be subject to the Commission's jurisdiction and therefore the question of reconciliation in that case did "not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power." *Id.* at 358.

This Court further observed that the Exchange Act contains no "form of review of exchange self-policing" as to its rules and therefore "[t]here is nothing built into the regulatory scheme which performs the *antitrust function* of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends." *Id.* at 358-359 (emphasis added). Furthermore, this Court ruled that ap-

plication of the antitrust laws to *particular instances of exchange enforcement* of exchange rules was "not at all incompatible with the fulfillment of the aims of the Securities Exchange Act," since "under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate" of the Act. *Id.* at 359-360. This Court stated:

> "Applicability of the antitrust laws, therefore, [rested in *Silver*] on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability [to the *Silver* facts] would defeat the congressional policy reflected in the antitrust laws *without serving the policy of the Securities Exchange Act. Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented.*"

Id. at 360 (emphasis added).[47]

In *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. 117 this Court recently reaffirmed and elaborated upon the principles of stock exchange pre-emption expressed in *Silver*. In *Ware,* this

[47] Finally, this Court concluded that the manner in which the NYSE and its members acted to disconnect the wire connections and stock ticker service to petitioners deprived the petitioners of such basic procedural safeguards that "the Exchange [had] . . . not even reached the threshold of justification under [the Exchange Act] . . . for what would otherwise be an antitrust violation." The Court therefore sustained the petitioners' antitrust challenge. 373 U.S. at 361-365.

Court considered whether a NYSE rule requiring arbitration of controversies arising out of the termination by an individual of his employment with an exchange member pre-empted California state law which afforded an employee the right to litigate wage disputes arising out of his employment. In its analysis, this Court stressed that the Exchange Act established a scheme of supervised self-regulation in which the Commission is provided with "direct supervisory" authority over exchange regulation and exchange rules relating to "12 designated subject areas and 'similar matters'" enumerated in Section 19(b). *Id.* at 129-30.[48] These matters, this Court reasoned, are germane to "the congressional aim in supervised self-regulation . . . to insure fair dealing and [the] . . . protection of investors from harmful or unfair trading practices" (*id.* at 130), and "[a]s a consequence, some exchange rules [*i.e.,* those not within the scope of Section 19(b)] are not subject to direct Commission scrutiny." *Id.* at 129.[49] Such an exchange rule which is not "directly

[48] In addition to its Section 19(b) authority, it was also noted in *Ware* that the Commission is given rulemaking authority in a number of other sections of the Act to promulgate rules which will affect the conduct of exchange members. 414 U.S. at 129, n. 10. See Sections 8, 9, 10, 11, 14 and 17 of the Exchange Act, 15 U.S.C. 78h, 78i, 78j, 78k, 78n and 78q.

[49] Indeed, the Commission urged this position in *Ware* in its brief *amicus curiae* to this Court where it stated at pages 11-12:

> "Exchange rules that are not substantially related to the statutory objectives should not be considered paramount to otherwise conflicting statutes. Compare *Silver* v. *New York Stock Exchange,* 373 U.S. 341. Rule 347(b), as applied here, cannot be said to be related to the regulatory objectives of the statute in any but the most indirect manner, and therefore it is not the type of exchange self-regulation within the scope and purposes

related to the Act's purposes" because it is not "designed to insure fair dealing and to protect investors," this Court stated, "would not appear to fall under the shadow of the federal umbrella [of stock exchange pre-emption]; it is instead, subject to applicable state law." *Id.* at 131.[50]

Unlike the instant case, where the challenged conduct—the fixing of minimum rates of commission—is directly within the scope of the Commission's regulatory authority under Section 19(b), the self-regulatory conduct at issue in both *Silver* and *Ware* was considered as not subject to the supervisory jurisdiction of the Commission. This Court explained in *Silver,* however, that the antitrust laws are repealed to the extent necessary to make the Exchange Act work and stated that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented." 373 U.S. at 360.[51]

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of the Securities Exchange Act that might oust conflicting provisions of state law. If the exchange rule in issue before this Court did involve a matter sufficiently important to the Act's objectives to be within the ambit of the Commission's pervasive regulatory oversight as delineated by the Act, state law in conflict with the rule would be preempted" (footnote omitted.).

[50] Since none of the subject matter categories of Section 19(b) was found to suggest "that the Commission has review authority with respect to a rule requiring arbitration of employer-employee disputes" (414 U.S. at 135, n. 14), and since the relationship between compulsory employer-employee arbitration and the matters enumerated in Section 19(b) was determined to be "'extremely attenuated and peripheral, if it exists at all,'" this Court held that the exchange's arbitration rule did "not require pre-emption of contrary state law." *Id.* at 135-137.

[51] This Court's application of the antitrust laws in *Silver,* in spite of its observation that the Commission may have had au-

Furthermore, in limiting its inquiry in *Silver* to the question of whether the NYSE's action could in fact be justified as effectuating a self-regulatory goal under the Exchange Act, because *Silver* did "not involve any problem of conflict or coextensiveness of coverage with the [Commission's] . . . regulatory power" (373 U.S. at 358), this Court contrasted the inquiry it was making with the inquiry it had made in other antitrust exemption cases in which the antitrust laws potentially conflicted with an agency's regulatory powers. *Georgia* v. *Pennsylvania R.R. Co., supra,* 324 U.S. 439; *United States* v. *Radio Corporation of America,* 358 U.S. 334; *California* v. *Federal Power Commission, supra,* 369 U.S. 482; *Pan American World Airways, Inc.* v. *United States, supra,* 371 U.S. 296. In those cases this Court did not resolve the question of implied repeal of the antitrust laws on the basis of whether the challenged conduct of the regulated entity, which was subject to the agency's jurisdiction, was, as a matter of fact, necessary to make the regulatory act work. Rather this Court examined whether or not, as a matter of law, it would be repugnant to the operation of the regulatory scheme intended by Congress to apply the antitrust laws to matters arguably subject to the agency's jurisdiction.[52]

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thority to order the NYSE to adopt a rule "providing a hearing and attendant procedures to non-members," 373 U.S. 364 n.16, does not establish, as the Department of Justice argues (DOJ Br. 19-20), that the antitrust laws are to be applied to existing exchange rules subject to the Commission's jurisdiction. For, as explained above, *Silver* involved a particular instance of exchange conduct which was not pursuant to any existing exchange rule; it did not involve the validity of an exchange rule.

[52] *Accord, Otter Tail Power Co.* v. *United States, supra,* 410

B. The Exchange Act's Regulatory Scheme Will Not Work As Congress Intended if the Antitrust Laws are Applied to Exchange Activity Respecting Matters Subject to the Commission's Jurisdiction Under Section 19(b).

It is the Commission's position that reconciliation of the antitrust laws with the regulatory scheme established in the Exchange Act requires that where exchange rules are clearly subject to the Commission's jurisdiction the antitrust laws must be found to be inapplicable. The Commission's view is that in order to make its regulatory jurisdiction over exchange rules work in the manner intended by Congress, it is necessary to pre-empt the antitrust laws.[33]

The regulatory scheme established in the Exchange Act was designed to provide regulation in an area where "the complicated nature of the problems justified leaving much greater latitude of discretion with the administrative agencies than would otherwise be the case"; "a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means." H.R. Rep. No. 1383, *supra*, pp. 6-7. Congress thus felt justified in vesting in the Commission, "within constitutional limitations, that measure of flexibility required

U.S. 366; *Hughes Tool Co.* v. *Trans World Airlines, Inc., supra,* 409 U.S. 363; *Carnation Co.* v. *Pacific Westbound Conference, supra,* 383 U.S. 213; *United States* v. *Philadelphia National Bank, supra,* 374 U.S. 321.

[33] See *Kaplan* v. *Lehman Brothers,* 250 F. Supp. 562 (N.D. Ill., 1966), *affirmed,* 371 F. 2d 409 (C.A. 7), *certiorari denied,* 389 U.S. 954. *J. R. Williston & Beane, Inc.* v. *Haack, supra,* [Current Binder] CCH Fed. Sec. L. Rep. ¶94,921.

in dealing with so intricate a subject matter" (*id.*), and accordingly granted to the Commission "broad discretionary powers" (*id.*)—powers to investigate the operation of the exchange market, to review existing exchange rules and to initiate prospective rules of general or particular application. This authority to formulate policy for the securities industry, and thereby in effect to legislate, cannot be exercised

> "in a cursory or incomplete manner or without having extensive hearings and examinations into the subject matter, and without permitting those interested, representing the public and groups in the securities industry an opportunity for a full expression of views."

Stark v. *New York Stock Exchange, Inc., supra,* 346 F. Supp. at 227.

Yet, if as the Department of Justice argues, district courts possessed jurisdiction under the antitrust laws over exchange operations concurrent with that of the Commission, the whole regulatory structure of the securities exchanges would be impaired. Enforcement of the antitrust laws involves no question of regulatory policy but merely application of existing standards to adduced facts.[34] A district court "acting on a single, isolated case-and-controversy record in a private suit"

[34] "[T]he judicial function is traditionally to weigh the merits of a particular controversy, but not to engage in a consistent determination of policy or to maintain steady contact with a general and continuing problem." Walter Gellhorn, "The Administrative Agency—A Threat to Democracy?" at 517 in *Separation of Powers and the Independent Agencies: Cases and Selected Readings,* prepared for the Subcommittee on the Judiciary of the Senate Committee on the Judiciary, 91st Cong., S. Doc. No. 91-49.

is simply not equipped to consider the broad economic policies involved—the interrelationship of a particular rule to the structure of the regulated industry, and the implications of abandoning that rule. *Cf., Port of Boston Marine Terminal Ass'n* v. *Rederiaktiabolaget Transatlantic,* 400 U.S. 62, 69.

Moreover, were a district court to apply the necessary-to-make-the-Act work standard to exchange rules subject to Commission jurisdiction—in the manner intended by *Silver* to operate with respect to exchange conduct *outside* the scope of Commission authority—the very purposes of Congress in vesting the Commission with supervisory authority would be frustrated. What is necessary to make the Act work today may be unnecessary or even counter-productive tomorrow. A period of experimentation may be required in order to resolve whether an exchange's rules are appropriate for present purposes,[55] even though there may be no present answer to the question of appropriateness in the long run.

This inability of the district courts to perform the regulatory function which Congress intended to impose over exchange operations, requires the conclusion that application of the antitrust laws to exchange rules *specifically subject to the Commission's jurisdiction* would be repugnant to the Exchange Act. To make the Securities Exchange Act work, it is necessary, at the minimum, that the Commission be able to perform the policy-making functions expressly assigned to it by that Act, in the application of standards set forth in

[55] *Cf. Delta Air Lines, Inc.* v. *Civil Aeronautics Board,* 455 F. 2d 1340, 1345 (C.A. D.C.).

that Act, through the procedures prescribed by that Act. The Exchange Act cannot be expected to work as Congress intended if district courts may render *ad hoc* decisions applying antitrust standards to matters involving the very structure of the securities industry and thereby pre-empt the Commission's policy-making functions. Antitrust jurisdiction would both (1) result in the fashioning of national policy respecting securities exchanges in part by entities which are not equipped to perform that function as Congress intended it to be performed and (2) inevitably lead to conflicts and inconsistencies in judgment between the Commission's determinations and the holdings of numerous antitrust courts. Because of this "plain repugnancy between the antitrust and regulatory provisions" (*United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 350-351), the antitrust laws must be held to have been impliedly repealed with respect to matters within the Commission's jurisdiction under the Act, and in particular with respect to the commission rate structure.

Similarly, as this Court observed in *Silver, supra,* 373 U.S. at 352, Congress intended through the Exchange Act to leave with the exchanges "the initiative and responsibility for promulgating regulations pertaining to the administration of their . . . affairs" subject to Commission jurisdiction. See S. Rep. No. 792, *supra,* at p. 13. Notwithstanding this congressional intent, this Court felt, in *Silver*, that application of the antitrust laws to exchange conduct not within the scope of Commission supervisory jurisdiction would not inhibit effective self-regulation because "under the aegis of the rule of reason, traditional antitrust con-

cepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act." 373 U.S. at 360. Application of the antitrust laws to conduct clearly within the Commission's supervisory jurisdiction, however, would inhibit the scheme of supervised self-regulation.

Any meaningful exercise of self-regulation will, as this Court recognized in *Silver,* 373 U.S. at 360, likely have some anti-competitive implications.[56] Thus, if, as asserted by the Department of Justice (DOJ Br. 48), the only antitrust umbrella afforded by Commission jurisdiction occurs when the Commission affirmatively promulgates a rule or order pursuant to Section 19(b)[57] then the exchange could be expected, contrary to congressional intent, to abdicate all but the most innocuous of their self-regulatory responsibilities and leave all initiative to the Commission in order to avoid the risk of substantial antitrust liability for engaging in self-regulation outside the umbrella of a Commission directive. Moreover, this risk of antitrust liability would almost certainly result in the exchange's resistance to informal Commission requests and directions which, in the Department of Justice's view, would not provide any umbrella against antitrust attack for anti-

[56] See also *J. R. Williston & Beane* v. *Haack, supra,* CCH Fed. Sec. L. Rep. ¶94,921.

[57] Indeed, the Department of Justice does not, apparently, even regard a formal Commission order registering an exchange and approving its rules pursuant to Section 6, as providing immunity from antitrust attack. See *United States* v. *Chicago Board Options Exchange,* No. 73 C 1085 (N.D. Ill., complaint filed April 26, 1973); DOJ Br. 42.

competitive action. In consequence, the congressional scheme which specifically contemplated that self-regulatory judgments would be made by the exchanges in the first instance would be abrogated and the cooperative partnership between public and private regulation established in the Act would be seriously eroded.

C. Antitrust Exemption for Exchange Conduct Subject to the Commission's Jurisdiction Is Compelled by This Court's Pronouncements Concerning Implied Repeal of the Antitrust Laws with Respect to Other Regulatory Schemes

1. Ricci v. Chicago Mercantile Exchange is consistent with recognizing an antitrust exemption for exchange rules subject to Commission jurisdiction

The Department of Justice recognizes that this Court in *Silver* did not reach the question of antitrust immunity with respect to exchange rules and practices subject to the Commission's jurisdiction, but rather noted that this question would present "a different case." 373 U.S. 360. The Department of Justice, however, says that *Ricci* v. *Chicago Merchantile Exchange,* 409 U.S. 289, is that "different case"[58] and relies heavily upon that decision. This reliance is misplaced. As the Chief Justice pointed out in his concurring opinion in *Ricci,* this Court in that case did not resolve the issue left open in *Silver.* As he said: "Indeed, the *Silver* problem is not before us." 409 U.S. at 308.

Ricci, like *Silver,* involved a private dispute between the petitioner Ricci and an exchange, in that case the

[58] DOJ Br. 20.

Chicago Merchantile Exchange. Ricci, contending that the exchange had improperly terminated his membership in violation of the rules of the exchange, the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*, and the anti-trust laws, filed an action in the district court. The district court dismissed the complaint, and on appeal the court of appeals directed the district court to stay further proceedings to permit administrative action by the Commodity Exchange Commission. This Court affirmed. In so doing, this Court, like the court of appeals, did not reach the question of antitrust immunity. All that was involved was an issue of primary jurisdiction over the particular dispute. This Court, 409 U.S. at 304, said the issue in *Ricci* "seems to depend in the first instance on whether the transfer of Ricci's membership was in violation of the Act for failure to follow exchange rules. That issue in turn appears to pose issues of fact . . ." [59] Insofar as *Ricci* is relevant at all to this case, it tends to support not reject antitrust immunity in the case at bar.

Essentially, this Court in *Ricci* affirmed reference to the Commodity Exchange Commission because it believed that factual findings of the administrative agency would "be of material aid in resolving the im-

[59] This Court, 409 U.S. at 305 n. 15 elaborated on these factual issues as follows:

"Likely issues for the fact-finder are whether Ricci revoked the transfer authorization before or after he was informed that his membership was transferred; whether the transfer authorization was valid; whether Siegel had a lien against Ricci's membership because of its loan to Ricci for the purchase of a membership; whether Siegel owed brokerage fees to Ricci; and if so, whether these brokerage fees could be offset against the debt for the membership purchase."

munity question." 409 U.S. at 302. This was true because, if the agency determined that the action of the exchange in terminating Ricci's membership was a violation of the rules of the exchange and therefore of the Commodity Exchange Act [60] then "the immunity issue will dissolve." 409 U.S. at 306. If, on the other hand, the agency were to find that the action of the exchange was in conformity with its rules, there would then be presented a question as to antitrust immunity which was "plainly substantial" 409 U.S. at 303,, and the administrative decision would assist the court in arriving "at the essential accommodation between the antitrust and the regulatory regimes." 409 U.S. at 307.

This Court concluded in *Ricci* that the question of whether the Chicago Merchantile Exchange could terminate Ricci's membership as a result of a dispute concerning indebtedness, without incurring antitrust liability, presented a "substantial" question as to immunity. In the light of this conclusion, the present case involving, as it does, the viability of the Securities and Exchange Commission's authority to regulate the structure and operations of the securities exchanges pursuant to express statutory mandate, would seem to present a clear case for such immunity.

[60] The Commodity Exchange Act, 7 U.S.C. 1, *et seq.*, requires a "contract market," such as the Merchantile Exchange, to have rules, which must be filed with the Secretary of Agriculture, and imposes a statutory duty upon such an exchange to enforce its own rules. That Act also empowers the Commodity Exchange Commission to conduct administrative proceedings for the purpose of determining whether or not a commodity exchange is enforcing its rules and to impose sanctions if such a failure of enforcement is found. It was for this type of determination that this Court referred Ricci's dispute to the agency.

The Department of Justice relies on *Ricci* for two principal propositions. First, that the antitrust courts rather than the administrative agency have authority to decide whether antitrust immunity exists (DOJ Br. 17)[61] and secondly, that the issue of antitrust immunity can be resolved only upon a "full record" because what is involved is "an aspect of the rule of reason."[62] (DOJ Br. 17, 24).

As to the first point, we do not contend that this Commission has exclusive authority to determine whether there is antitrust immunity, but, on the contrary, we recognize that this question is properly before this Court. Our position, of course, is that this Court should decide—as have the courts below—that on the circumstances relevant to this case immunity does exist.

As to the second point, this Court did conclude in *Ricci* that an administrative record as to the facts involved in Ricci's dispute with the exchange would be

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[61] The Department of Justice relies particularly upon a footnote in the *Ricci* opinion in which this Court referred to the fact that there was no express grant of antitrust immunity in the Commodity Exchange Act and concludes that Congress did not intend the *adjudicative* authority given the Commodity Exchange Commission to be a complete substitute for judicial enforcement of the antitrust laws. (DOJ Br. 22) That proposition does not support the contention that the Commission's *regulatory* jurisdiction over stock exchanges is to be superseded by the antitrust laws.

[62] The suggestion of the Department that under *Silver* the issue now before this Court is "an aspect of the rule of reason" misreads the *Silver* decision (DOJ Br. 24). This Court indicated in *Silver* that, while no antitrust immunity existed in the *absence* of Commission power to review a particular exchange exercise of self-regulation, even in that situation, and only after that finding, the rule of reason could be applied to permit the exchange "sufficient breathing space within which to carry out the mandate of the Securities Exchange Act." 373 U.S. 360.

helpful to the antitrust court, although it did not suggest that such a record was essential. In the case at bar, however, we believe that both of the courts below by summary judgment properly disposed of the issue as to whether the Commission's express statutory authority to regulate and supervise the stock exchanges should be superseded and disrupted by antitrust challenge. There is not any real dispute as to the facts. The exchanges do fix commission rates and have done so for over 180 years, and there is no doubt as to the Commission's authority over that practice. The question before this Court is not, as the Department of Justice seems to suggest, whether the rates prevailing at any particular time were reasonable or even whether it was necessary to have fixed rates at all under the conditions prevailing at the time this plaintiff commenced his action. Rather, the issue is whether the Commission's jurisdiction over the subject of commission rates should be preserved as a part of the comprehensive scheme for Commission regulation of the securities markets.

This point is vividly illustrated by the concession of the Department of Justice that "If the SEC were to order the exchanges to adhere to a fixed commission rate system of some kind, no antitrust liability could arise." (DOJ Br. 48). A fixed rate system existed when the Exchange Act was adopted, and Congress, as well as the Commission, recognized its existence. No Commission order was required to create such a system, but the continuance of a fixed rate system *was* predicated upon a formal order of the Commission issued in 1934 registering the defendant exchanges as national securities exchanges under Section 6 of the Exchange Act. As

we have observed earlier, any exchange seeking to be registered as a national securities exchange in 1934 was required to file with the Commission copies of its articles of incorporation, bylaws and all rules and regulations—which included its rules requiring its members to charge fixed commission rates on all transactions effected on the exchange. The Commission, then, in 1934, after finding that the rules and regulations of the defendant exchanges (including rules relating to a fixed commission rate system) were "just and adequate to insure fair dealing and to protect investors" exercised its jurisdiction under Section 6(d) of the Exchange Act to register the exchanges by the issuance of a formal "order."[63]

As we observe at some length in Part II D *infra*, the Commission has exercised its jurisdiction over the fixed rate system ever since. The Commission has conducted studies and held hearings over the years to study the fixed rate system as conditions changed in the securities markets. The Commission initially responded to changing conditions in the securities markets by taking various steps—including the informal procedures included in its package of regulatory tools under the Exchange Act—designed to modify the commission rate structure without, at the same time, unnecessarily disrupting exchange operations or impairing investor protection. Ultimately concluding that a fixed commission rate system was no longer necessary or appropriate, the Commission in 1975, by rule directed the exchanges to

[63] See Order of Commission issued to NYSE, (September 28, 1934) (A-238). In its order the Commission also specifically made reference to its power "under Section 19 and other sections of said Act" to alter or supplement rules of the exchange (A-239).

terminate that system, thus in effect ordering them *not* to adhere to such a system, a result which the Department of Justice now applauds. Securities Exchange Act Release No. 11203 (January 23, 1975) (Doc. App. 109).

Thus, it is clear that the fixed commission rate system of the defendant exchanges was initially approved by the Commission by formal "order" in 1934, has been consistently approved, modified and altered by the Commission through its less formal regulatory tools during the intervening 41 years, and has culminated in 1975 through the issuance of another formal "order" by the Commission. In view of this history of the Commission's exercise of its statutory jurisdiction over the practice of fixed commission rates, it is particularly difficult to comprehend how the Department of Justice can now urge application of the antitrust laws to this practice and at the same time concede that "no antitrust liability could arise" if the SEC "were to order the exchanges to adhere to a fixed commission rate system." DOJ Br 48.

The foregoing demonstrates the Department of Justice's misplaced reliance on *Ricci*. In this case there exists specific statutory jurisdiction by an administrative agency over an important aspect of a regulatory scheme, which is to be, and has been, exercised through formal orders and other regulatory means specifically contemplated by the Act. There simply are no facts needing resolution by a trier of fact. What we have here is a question of law—whether there is a plain repugnancy between the antitrust laws and the regulatory scheme embodied in the Exchange Act—precisely the

issue of implied repealer this Court said in *Ricci* would be reached *after* the factual issues were resolved."

2. Each of the elements which this Court has considered necessary in order to find an implied repeal of the antitrust laws is present here.

The Commission's position, that exchange rules specifically subject to its jurisdiction are immune from antitrust attack, is in harmony with this Court's past precedents. An examination of this Court's decisions regarding implied repeal of the antitrust laws with respect to other regulatory schemes makes plain that repugnancy between the antitrust laws and the regulatory scheme turns upon the existence of two elements attendant to the regulatory scheme; both of these elements are present in the Exchange Act.

First, this Court has required that the conduct challenged under the antitrust laws be subject to the juris-

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[64] Both the majority and dissent suggested in *Ricci* that the jurisdiction of the agencies established under the Commodities Exchange Act was so limited that that regulatory scheme could not be viewed as a substitute for the application of the antitrust laws. 409 U.S. at 302, n. 13, 312-313. As we have shown above, the jurisdiction of the Commission established under the Securities Exchange Act to supervise the rules of securities exchanges is plenary and therefore markedly different from the regulatory scheme respecting commodities exchanges existing at the time of the *Ricci* dispute. Indeed, because it viewed the regulatory scheme over commodities exchanges, which operated at the time of the *Ricci* dispute, as inadequate, Congress has recently created "an agency comparable in stature and responsibility to the Securities and Exchange Commission" to regulate more completely commodities exchanges. Senate Committee on Agriculture and Forestry, *The Commodities Futures Trading Commission Act of 1974*, 93d Cong., 2d Sess., p. 2 (Committee Print); *see also* 120 Cong. Rec. 2924, 2928.

diction of the regulatory agency to supervise and review. Thus, in *Pan American World Airways, Inc.* v. *United States, supra,* 371 U.S. at 305, in finding an implied repeal, this Court specifically noted that the "acts charged . . . are precise ingredients" of the administrative agency's authority. On the other hand, where this Court has found that the regulated entity's anti-competitive conduct is outside the scope of agency supervisory jurisdiction vested by a regulatory statute, it has refused to recognize an implied repeal of the antitrust laws. See *Georgia* v. *Pennsylvania R.R. Co., supra,* 324 U.S. at 456-457; *Silver* v. *New York Stock Exchange, supra,* 373 U.S. 341; see also *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra,* 411 U.S. 726 (where a one-time rate fixing agreement was found to be outside the scope of the Federal Maritime Commission's express authority to grant antitrust immunity to ongoing rate fixing agreements between shippers, and hence subject to antitrust attack); *compare Hughes Tool Co.* v. *Transworld Airlines, Inc., supra,* 409 U.S. 363 (finding an exemption from the antitrust laws with respect to conduct subject to the jurisdiction of the Civil Aeronautics Board) *with id.* at 389 (dissenting opinion urging that the challenged conduct in that case was outside of the CAB's "substantive mandate" to review). As the preceding analysis of the structure and policy of the Exchange Act makes clear, the Commission was expressly granted continuing supervisory jurisdiction over any important matters relating to stock exchanges including, specifically, the fixing of commission rates.

Second, this Court has refused to find an implied

repeal of the antitrust laws, even where a regulatory agency has jurisdiction to supervise the challenged conduct and even when in the course of exercising that jurisdiction the agency is required to consider competitive factors, if in the context of the regulatory scheme the agency's jurisdiction is not intended to be a substitute for the antitrust function. See *California* v. *Federal Power Commission, supra,* 369 U.S. 482; *United States* v. *Philadelphia National Bank, supra,* 374 U.S. 321; *Otter Tail Power Co.* v. *United States, supra,* 410 U.S. 366. But where it has found that the question of whether the challenged conduct "meet[s] the standards of competition and monopoly provided by the [regulatory] Act is peculiarly a question for the administrative agency," then in order to avoid the collision of two regimes which might result "[i]f the courts were to intrude independently with their construction of the antitrust laws," this Court has recognized an implied repeal. *Pan American World Airways* v. *United States, supra,* 371 U.S. at 309-310. Recognition of an implied repeal in such circumstances is consistent with this Court's repeated concern to avoid "sporadic action by federal courts [which] would disrupt an agency's delicate regulatory scheme. . . ." *United States* v. *Radio Corporation of America, supra,* 358 U.S. at 348; see also *Carnation Co.* v. *Pacific Westbound Conference, supra,* 383 U.S. at 220-221. While the Commission must, and does, consider competitive factors in supervising exchange rules, it must balance those factors against other policies of the Exchange Act in order to formulate a complete regulatory policy which it finds to be "necessary or appropriate."

Moreover, as we have demonstrated, the Commission's exercise of its regulatory mandate will not work if the courts independently subject matters within the Commission's Section 19(b) jurisdiction to "their construction of the antitrust laws." *Pan American World Airways* v. *United States, supra,* 371 U.S. at 310.

D. The Public Record of Commission Supervision Over the Exchanges' Commission Rate Structure Illustrates the Necessity of Leaving Such Matters Solely to the Jurisdiction of the Commission.

Since application of the antitrust laws to exchange rules concerning the fixing of minimum commission rates as well as to all other exchange practices that are within the scope of the Commission's supervisory jurisdiction would be inimical to and would frustrate the regulatory scheme of the Exchange Act, such rules and practices must be considered to be immune from antitrust attack even where they have not been specifically mandated by a formal rule or order of the Commission under Section 19(b). The necessity for pre-emption of the antitrust laws is fully supported by the public record of the Commission's active exercise of its jurisdiction over the commission rate structure of the exchanges. This record illustrates the effectiveness of the formal and informal processes contemplated by the Act for dealing with the complex and subtle issues posed in formulating policy with respect to exchange rules. It also substantiates the necessity for leaving exchange self-regulatory conduct, with respect to matters which Congress brought within the scope of the Commission's authority, to the exclusive jurisdiction of the Commission.

The respective fixed commission rate structures of the NYSE and the AMEX were approved by the Commission in 1934 when the Commission granted the applications of those exchanges for registration as "national securities exchanges" pursuant to Section 6 of the Exchange Act (43a-44a, 217a, 229a-239a). Thereafter, the defendant exchanges amended their rules respecting commission rates from time to time, submitting copies of these amendments upon their adoption to the Commission for its review in accordance with Section 6(a) of the Act (44a, 218a).

Pursuant to a congressional mandate in 1961, 15 U.S.C. 78s(d), the Commission published in 1963 a six-volume Special Study of Securities Markets, H.R. Doc. 95, 88th Cong., 1st Sess. (hereinafter cited as "Special Study"), which contained the results of a detailed investigation by the Commission's staff of the operation of the securities industry. Commencing in 1964, the Commission's staff and the exchanges initiated discussions to implement the recommendations of the Special Study (44a, 219a-220a). Then, in 1968, in order to examine fully certain practices pertaining to fixed stock-exchange-commission rates, the Commission held investigatory hearings, pursuant to Section 21(a) of the Exchange Act, 15 U.S.C. 78u(a),[65] on the commission rate structure of securities exchanges and the

[65] Section 21(a) of the Exchange Act authorizes the Commission "in its discretion, . . . to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid . . . in the prescribing of rules and regulations. . . [under the Exchange Act], or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates."

securities industry (99a, 284a-240a).[66] Again, commencing on October 12, 1971, also pursuant to Section 21(a) of the Exchange Act, the Commission held further public hearings on the structure of the securities markets. Interested persons appeared and presented their views with respect to various interrelated matters concerning the appropriateness of modifications to the structure of the securities markets.[67] Upon conclusion

[66] The Commission announced the commencement of these hearings on May 28, 1968. See Securities Exchange Act Release No. 8324 (1968) (286a-287a). These hearings, which were conducted through the summer of 1971, were intended to elicit information on, among other things, how the securities industry worked and whether "a minimum exchange commission rate structure is necessary" to the operation of the securities industry. *Id.*

[67] In Securities Exchange Act Release No. 9315 (August 26, 1971) the Commission announced that the following matters were to be considered during the hearings:

"(1) The desirability, structure and means of developing a national system of securities exchanges and the relationship of such a system to other securities markets;

"(2) So-called 'institutional membership' on exchanges including (i) exchange membership by financial institutions (such as insurance companies, trust companies, foundations, investment companies and pension funds); (ii) exchange membership by affiliates of financial institutions such as their investment advisers, managers, parents, subsidiaries or other affiliates, who may utilize such memberships either to execute portfolio transactions for an institutional affiliate or in one way or another to facilitate the recapture of commissions by an institution or to conduct a general securities business as an exchange member, or any combination of the foregoing; (iii) exchange membership by other organizations whose primary business may not be that of a broker or dealer or their affiliates; (iv) whether and the conditions under which any of the foregoing persons should be permitted to engage in the business of a broker or dealer in securities (aside from acting as underwriters for the shares of one or more investment companies);

of these hearings, and following publication in 1971 of a second Congressionally-mandated study of the securities markets by the Commission—*The Institutional Investor Study,* H.R. Doc. No. 92-64, 92d Cong., 1st Sess.—the Commission issued a *Statement on the Future Structure of the Securities Markets* (February 2, 1972) (hereinafter cited as "Policy Statement"), in which it enunciated its commitment to the creation of a central market system in listed securities (239a).

In the Policy Statement, the Commission noted that one of the major barriers to the central market system was the fixed minimum brokerage commissions. Policy Statement, p. 15 (385a-386a).[68] Nevertheless, the Com-

"(3) Restrictions on access of non-members to exchange markets and of exchange members to the third markets;

"(4) The reasons for differing regulation of securities markets and the kind of additional or modified regulation, if any, which may be needed;

"(5) The need for additional disclosure of information on prices, volume and quotations in all markets, and the nature thereof through a composite tape or otherwise, and

"(6) Competition among exchange and between exchanges and other markets."

[68] The Commission observed that fixed minimums may not only have been at an unreasonable level, but also may have caused the serious side effects of

"(a) Dispersion of trading in listed securities

(b) Reciprocal practices of various kinds.

(c) Increasing pressure for exchange membership by institutions."

Policy Statement, p. 15 (385a). These side effects, the Commission stated, were obstacles to the central market system in that they cause

"certain markets and market makers . . . to choose to stay outside the system in order to compete in service charges as well as in execution, as the third market does, or in order to compete, as certain regional exchange do, for institutional business by directly or indirectly providing institutions with rebates of commissions." *Id.*

mission observed that "we are dealing with an industry which has operated under fixed commission rates for a very long time." *Id.* (386a). Consequently, while the Commission expected that the goals of "competitive rates and the creation of a centralized market system" would have desirable incidents, it was at the same time concerned that competitive rates might result in

> "deterioration in standards of service and responsibility or . . . higher transaction costs owing to increased spreads and fluctuations, or [the possibility that] . . . investment managers [will make] . . . visible commission cost an exclusive criterion in deciding where to place their executions and [thus ignore] . . . through carelessness or fear of criticism, the elements of skill, knowledge, judgment and advice."

Id. at p. 14 (384a).

In the Commission's view, "[a]ny changes in the commission structure should not reverse" the ongoing process of upgrading broker-dealer "standards of service to the public including the provision of adequate information, advice, care and responsibility." *Id.* at pp. 15-16 (386a). Thus, the Commission concluded that "[i]t is necessary to measure the effect of competitively determined commissions very carefully on a step-by-step basis." *Id.* at p. 15 (386a). While "[t]he principal argument in favor [o]f fixed minimum commissions is the severe decline in the revenue of the securities industry predicted to result if competitive rates were suddenly introduced on all institutional business," it was the Commission's opinion that the indus-

try should be able to adjust to the introduction of competitive rates, "at least on large orders, at a measured deliberate pace." *Id.* at p. 16 (387a).[69]

These views reflected a reaffirmation of conclusions that the Commission had earlier reached "that fixed minimum commissions on institutional size orders are neither necessary nor appropriate" (351a, 353a).[70]

[69] The Commission's letter, transmitting the Institutional Investor Study to the Congress, stated:

"We have . . . taken initial steps to require competitive rates . . . which we believe will have ameliorating effects on future developments in a number of the areas studied. Assuming that the step called for is timely implemented by the . . . [NYSE], the Commission's subsequent steps in this and related areas must necessarily be guided to a considerable extent by its experience with the initial step. . . . In this situation we believe the sound regulatory course is to proceed with caution on any further concrete recommendations concerning the structure of the securities markets" (footnote omitted).

Securities and Exchange Commission, *Institutional Investor Study*, H.R. Doc. No. 92-64, 92nd Cong., 1st Sess., Pt. 1, pp. vii-viii.

The Commission's approach of a phased introduction of competitive rates has been endorsed in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., *Securities Industry Study*, p. 60 (Committee Print), in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., *Securities Industry Study*, at p. 62. (Committee Print); and in United States Department of the Treasury, *Public Policy for American Capital Markets*, p. 6 (1974).

[70] The Commission's reservation concerning the exchanges' fixed minimum commission rate system as it related to large trades dates back to the Special Study of 1963. See Special Study, pp. 328-351. In the Special Study it was noted that since the commission rate structure of the exchanges allowed no discount for large volume trades, although the cost per share to the broker effecting such transactions was significantly less than for smaller volume trades, certain practices occurred. *Id.* Among these were the execution of large trades off the exchanges in order to take advantage of

Thus, on October 22, 1970, the Commission had taken a position in a letter to the NYSE that fixed minimum commission rates "for that portion of orders in excess of $100,000" were unreasonable. Securities Exchange Act Release No. 9007 (1970) (384a).[71] The Commission later determined "not [to] object to the . . . [NYSE's] commencing competitive rates on portions of orders above a level not higher than $500,000 rather than the $100,000 figure . . . ," but insisted that this be done by April 10, 1971 (353a-354a). Most exchanges had implemented competitive commission rates above that level by April 5, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971).

Thereafter, the Commission observed the effect of negotiated rates above $500,000.[72] Having done so, the

discounts derived from the economies of size and the practice by exchange members of making unauthorized reciprocal payments at the direction of persons who channeled large trades to the exchange member. *Id.* See also 219a-220a.

For a period after the Special Study, the Commission's staff and representatives of the exchanges met to discuss implementing the recommendation of the Special Study that these practices be curbed (44a-45a). Then, in 1968, the Commission took direct steps to relieve the problems by requesting the exchanges to integrate into their commission rate system a volume discount or alternatively to eliminate minimum commissions on portions of orders above $50,000 (46a).

[71] The Commission's conclusion that it was unreasonable for securities exchanges to prescribe fixed rates on portions of orders above $100,000 was conveyed to the exchanges as part of a letter to the NYSE. The letter was intended to advise the NYSE of those aspects of a new increased commission rate schedule prepared by the NYSE which the Commission found not to be reasonable. The NYSE's new schedule originated as an interim surcharge that the NYSE sought to place on small orders in order to compensate for severe financial conditions which its members suffered in 1969-1970.

[72] In its letter of October 22, 1970 to the NYSE (see p. 67

Commission concluded in its February 1972 Policy Statement that while

> "further reductions in the breakpoint [*i.e.*, the transaction size above which rates must be negotiated] might have a more severe impact on the income of certain kinds of member firms, on the services they provide, on their role in the capital markets, including the distribution of securities,

supra) the Commission had requested the exchange to submit no later than June 30, 1971, a "new rate schedule of scaled percentage charges based upon the amount involved in an order" (352a). On April 14, 1971, the Commission informed the securities industry that any further reduction of the negotiated rate breakpoint would be deferred pending the submission expected from the NYSE on June 30, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971). The Commission intended:

> "to observe the workings of competitive commission rates on orders in excess of $500,000 to consider carefully all questions which arise as a result thereof."

Id.

In September 1971, after receipt and analysis of the submissions and the public comments thereon, the Commission announced that it was not disposed at that time to lower further the breakpoint to a level below $500,000, but would continue to

> "study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000."

Securities Exchange Act Release No. 9351 (September 24, 1971). (Doc. App. 158) The Commission advised the NYSE that since "a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates" the NYSE should continue to "review its commission rate structure," "gather necessary data from its members" and submit any modifications or changes in its commission rate structure to the Commission "to enable [the Commission] to exercise its continuing regulatory oversight." *Id*, (Doc. App. 157).

> and on the desires of institutions and their managers to recapture commissions or otherwise use them for their benefit,"

it would nevertheless be appropriate for a $300,000 breakpoint to take effect in April of 1972. Policy Statement, p. 16 (387a, 401a).

On May 31, 1973, in response to severe financial conditions in the securities brokerage industry, the NYSE submitted to the Commission proposed amendments to its constitution and rules which would result in an increase in the commissions charged by NYSE members (Doc. App. 24). Shortly thereafter—on June 6, 1973—the Commission commenced "a public investigatory hearing . . . to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules" Securities Exchange Act Release No. 10206. (Doc. App. 24). On September 11, 1973, the Commission publicly announced its "conclusions concerning the commission rate proposals of the . . . [NYSE]. . . ." (Doc. App. 27). The Commission concluded that it would not object if the NYSE should immediately adopt its proposed commission rate increases, effective through March 31, 1974. The Commission further concluded that it would not object to the continuation of those increases from April 1, 1974, through April 30, 1975, subject to the condition that the NYSE first adopt certain other rules to become effective by or before April 1, 1974.[73] The

[73] Specifically, the Commission's conclusion not to object to the continuation of the increase after April 1, was conditioned upon the adoption of rules to "(a) eliminate that portion of NYSE Rule 383

Commission stated in its announcement, however, that "it will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result." (Doc. App. 28). The Commission further concluded that it would "not initiate in April 1974, a breakpoint reduction below $300,000 respecting the portion of orders above which rates may be competitively determined," Securities Exchange Act Release No. 10383 (Doc. App. 28).

Subsequently, in a letter from the Commission to the NYSE, dated December 14, 1973 (Securities Exchange Act Release No. 10560; Doc. App. 29), the Commission explained that in view of the fact that in the Exchange Act "rules concerning exchange-required fixed commission rates [were matters] that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted, the Commission after having considered a number of factors, "could not conclude that the NYSE's rate proposal was unreasonable" (Doc. App. 32-33). Accordingly, the Commission was "motivated . . . to raise no objection to the NYSE's rate increase for the period ending March 31, 1974" (Doc. App. 36).

The Commission also explained that its

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prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedules and (b) [to] permit, but . . . not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for a discount of up to 10 percent from the commission rate schedule . . . [that had been proposed by the NYSE]" (Doc. App. 28).

"conclusion that it would be appropriate to require exchanges to eliminate fixed rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate proposed by the NYSE" (Doc. App. 36).

The Commission reasserted that

> "the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature." (Doc. App. 37).

The Commission further stated that, while it would not necessarily require the NYSE, as a condition to continuing the rate increase after April 1, 1974, to adopt a rule allowing customers a 10% discount from

the fixed rate for reduced services from their broker,"[74] it adhered to the objective reflected in its September 11, 1973 conclusions "that the exchanges take steps to effect a meaningful experimental period prior to the introduction of completely unfixed rates. . . ." (Doc. App. 39). The Commission explained that with the "limited price competition [it expected] . . . all exchanges will effect," a broader range of investors would "have the opportunity to react to" competitive rates than would result from simply lowering the competitive-rate breakpoint below $300,000. (Doc. App. 40) Accordingly, the Commission determined that it would not be necessary to lower the breakpoint in April of 1974.

In response to the Commission's reaffirmation of its objective to provide for a meaningful experimental period, the NYSE submitted to the Commission proposed amendments to its constitution and rules to allow for competitively-determined commission rates on public orders of $2,000 or less commencing on April 1, 1974 (Securities Exchange Act Release No. 10670. Doc. App. 42). The NYSE's proposed rule changes did not provide, however, that intra-members rates on portions of orders of $2,000 or less be competitively determined. The Commission decided not to raise any objection to these rule changes but conditioned its non-objection on the expectation that the exchanges will "promptly . . . implement any necessary rule and constitution changes" if "the Commission determines, as a result of its study of the matter, that exchange ex-

[74] See note 73, *supra*.

periments with limited price competition should be broadened to encompass intra-member rates" (Doc. App. 44)."[75]

Following the Commission's hearings on intra-member rates, the Commission announced on September 19, 1974, that it had written to the presidents of each registered securities exchange stating (1) that in its view ample opportunity had been provided exchange members "to develop business strategies for, and to adjust their operations to, an unfixed rate environment"; (2) that it was "not persuaded, on the basis of the data and views obtained as a result of [the intra-member rate hearings] that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates," and (3) that the exchanges were formally requested, pursuant to the Commission's authority vested "under the Securities Exchange Act and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder", to "effect necessary changes in their constitution, rules, and practices" to eliminate fixed rates "effective on or before May 1, 1975." Securities Exchange Act Release No. 11019 (September 19, 1974) (Doc. App. 60-64).

[75] In order to aid its study of the matter, the Commission, on April 23, 1974, announced the commencement of public investigatory hearings beginning on May 29, 1974

> "to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commissions on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission" Securities Exchange Act Release No. 10751 (Doc. App. 49).

As a result of responses received by the Commission with respect to its September 19 request, the Commission determined to publish for comment, on October 24, 1974, proposed Rules 19b-3 and 10b-22 which would prohibit exchange rules fixing commission rates and establish procedures to regulate agreements to fix commissions on exchanges. Securities Exchange Act Release No. 11073 (October 24, 1974) (Doc. App. 65). The Commission also announced that it would hold hearings, beginning on November 19, 1974 with respect to its proposed rules. *Id.*"[76]

Following hearings on its proposed rules [77] the Commission announced on January 23, 1975, adoption of Rule 19b-3, proscribing exchange rules or practices fixing commission rates as of May 1, 1975.[78] Securities

[76] In Securities Exchange Act Release No. 11093 (November 8, 1974), the Commission provided, in anticipation of its hearings, a synopsis of the Commission's extensive regulation of fixed rates since 1963. (Doc. App. 81).

[77] The Antitrust Division of the Justice Department submitted a memorandum in these hearings in which it asserted that "the thrust of the [Exchange Act] is to authorize the Commission to take such remedial or reform actions with respect to exchange practices as the Commission deemed necessary or appropriate to effectuate the purposes of the Act"; and as a result, the Commission may "prohibit the exchanges and their members from fixing commission rates." Comments of the United States Department of Justice, Proposal to Adopt Securities Exchange Act Rules 19b-3 and 10b-22, Securities Exchange Act File No. 4-176 (December 10, 1974), pp. 6-7. Apparently the Department of Justice believes that the powers granted to the Commission in Section 19(b)(9) to regulate the fixing of "reasonable rates of commission" gives the Commission the authority to *abolish* fixed commission rates but *no* power to authorize any level of fixed rates.

[78] Rule 19b-3 provides:

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide in its rules of the exchange that nothing therein or in its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for combinations of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

Exchange Act Release No. 11203 (January 23, 1975) (Doc. App. 109). In its release announcing adoption of Rule 19b-3 the Commission explained:

"The basic reason for the Commission's decision to adopt Rule 19b-3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the

public interest than any system of price fixing which can reasonably be devised. . . . It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons." *Id.* at pp. 24-25 (Footnote omitted) (Doc. App. 133-134).

The Commission specifically cautioned, however, that its adoption of Rule 19b-3

> "does not reflect any judgment by the Commission that the fixed commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to [in] its release that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions, and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary."

Id. at p. 26 (Doc. App. 136-137)."[79]

The Commission's program since 1968 of modifying the exchanges' fixed rate structure has been paralleled by related Commission initiatives which affected the exchanges' commission rate structure as it related to the proposed central market system. One of these initiatives was a program to provide non-member broker-dealers with greater access to the exchange market while fixed rates continued on the exchanges.[80]

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[79] Because the Commission recognized (1) "that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to a new environment"; (2) that certain exchange members apparently did not realize that the Commission's September 11, 1973 conclusions were applicable to floor brokerage rates as well as non-member rates, and thus "may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide"; and (3) that "floor brokerage rates have considerably less impact on public investors than do public rates," it concluded that the date for elimination of floor brokerage rates should be May 1, 1976, instead of May 1, 1975. *Id.* at pp. 1-2 (Doc. App. 110).

[80] The NYSE, until the implementation of the Commission's program in this area, prohibited its members from splitting commissions for transactions executed on the NYSE. The AMEX had a similar prohibition. These prohibitions, known as anti-rebate rules, were intended to preserve the integrity of the exchanges' fixed minimum commission rate system. See *Thill* v. *New York Stock Exchange, Inc., supra,* 433 F. 2d 267.

The October 22, 1970, letter in which the Commission first requested that the NYSE adopt competitively-established commissions above certain levels (see *supra,* p. 67) (352a), also instructed the NYSE to submit, no later than June 30, 1971, a plan that would, provide "for reasonable economic access to the New York Stock Exchange for non-member broker-dealers." Such a program would of course, provide non-members with a means of participating in the exchange market at rates below the otherwise applicable

A second action taken by the Commission, which relates to the fixed minimum commission rate system, was the Commission's promulgation on January 16, 1973, of Rule 19b-2 under the Exchange Act, 17 CFR 240.19b-2. The rule is intended to limit the use of exchange memberships for other than public purposes. Securities Exchange Act Release No. 9950 (January 16, 1973).[81]

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minimum commission rates. Thus, the Commission's request for a plan of non-member access, like its decision to implement negotiated rates at certain levels, reflected its conclusion that the commission rate structure, as it had been applied, was no longer necessary or appropriate under the standards contained in Section 19(b). But just as the Commission had been concerned that a precipitous leap to fully negotiated rates might have a calamitous impact upon the securities markets, it took steps to assure that changes in access for brokers would provide meaningful profits from stock exchange transactions executed for their customers, and that such changes would not occur at the expense of the stock-exchange-member sector of the securities industry. Consequently, when the NYSE in mid-1971, submitted a proposal allowing non-members a discount of 30 percent from the public rate (Doc. App. 159), the Commission insisted that

> "the discount afforded non-member broker-dealers should not be less than 40% to allow for a minimum meaningful test of this proposal" Securities Exchange Act Release No. 8324, (Doc. App. 149).

A 40 percent discount for non-members went into effect in late March of 1972.

[81] In announcing Rule 19b-2's adoption, the Commission noted that the rule satisfied several objectives, including

> "The need to structure a central market system, the need to eliminate unfair trading advantages, the need to restore and insure investor confidence in our trading markets, the need to foster meaningful competition in the securities industry, and the need to promote the orderly introduction of competitive commission rates on large-size securities transactions. . . ."

Id. at p. 188. Regulation of the use of exchange memberships was found to be necessary to implement the Commission's program of

Finally, in its recent release announcing the adoption of Rule 19b-3 the Commission addressed itself to another problem related to the problems of non-member access to exchanges and institutional membership on exchanges—namely, the question of whether the elimination of fixed rates would reduce economic incentives to retaining exchange membership.[82]

The foregoing makes clear that the Commission has since 1961 been engaged in a continuing regulatory program which has sought to examine fully the nature and effect of the national securities exchanges' fixed rate system, and which has sought to structure the exchanges' operations not only with respect to the commission rates themselves but also with respect to a myriad of interrelated and interdependent matters. It

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introduction of competitive rates because the use of exchange membership by institutions for the purpose of recapturing brokerage commissions "would be tantamount to competitive rates (or no commissions at all) on all size orders for those institutions immediately" as a result of which "the Commission's phase-in-program would . . . become an academic exercise, at best." *Id.* at p. 107.

[82] The Commission stated that while "these concerns appear exaggerated" and do "not provide an adequate basis for deferring competitive rates" since they can be dealt with in other ways, nevertheless

> "[i]f it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act Release No. 11203, p. 43 (Doc. App. 154). In this connection, however, the Commission specifically cautioned that while it intended to receive comments on this problem

> "proposals which appear on their face to be anticompetitive can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate" *Id.* (Doc App. 155).

is hard to conceive of a better example to demonstrate the necessity for entrusting exchange operations to an administrative agency with continuous supervisory jurisdiction, rather than to the *ad hoc* jurisdiction of antitrust courts.[83]

CONCLUSION

In adopting the Securities Exchange Act of 1934, Congress intended to establish a national policy for the regulation of transactions on securities exchanges. To accomplish this goal, the Commission was vested with

[83] In order to carry out its broad regulatory responsibility over the exchange markets the Commission has an entire division consisting of 117 full time employees, its Division of Market Regulation, devoted to the development and implementation of regulatory policies and programs, as well as dozens of other staff personnel employed in other offices and divisions.

Not only does the record of Commission action with respect to commission rates illustrate the wisdom of Congress in delegating to the Commission quasi-legislative jurisdiction over the exchanges' rate structure, but the history of active exercise of Commission authority also requires that the exchanges' present rate structure be found immune from antitrust attack, even if this Court were to hold that the fact of jurisdiction by the Commission over the exchanges' fixed commission rate system alone does not afford such immunity.

The commission rate system existing at the time of the institution of this action, as well as the present system, is the product of the Commission's ongoing supervision. In the course of exercising this authority, the Commission determined that any precipitous move toward fully negotiated rates was not appropriate, but rather that the elimination of fixed rates at various levels should be the product of a deliberate, considered administrative program. It is just this type of action by a regulatory agency which this Court has held displaces the antitrust laws. *See Hughes Tool Co.* v. *Trans World Airlines, Inc., supra,* 409 U.S. 237. To allow an antitrust attack in this case "would disrupt" the Commission's delicate regulatory scheme, and would throw existing rate structures out of balance." *United States* v. *Radio Corporation of America, supra,* 358 U.S, at 348.

"broad powers over the exchanges to insure their efficient and honest functioning." [84]

But, creation of a scheme of regulation embodied in the Exchange Act did not take place in a vacuum. Rather, Congress appropriately took into consideration practices that had evolved over nearly 150 years of exchange operations without government regulation. As a result, in order to preserve the initiative and imagination of the exchanges already in existence, as well as to spur the exchanges to develop ethical and legal standards for the governance of the daily business conduct of their members, the Exchange Act explicitly contemplated that registered exchanges would be able to propose new regulatory standards and reevaluate their existing requirements. To oversee this "statutorily imposed duty of self-regulation" [85] the Commission was provided with continuous and complete regulatory control of the exchange mechanism through direct authority to adopt its own rules concerning specific areas of conduct of exchanges and their members and by the sweeping provisions of Section 19(b) empowering the Commission to alter, modify, repeal or amend exchange rules governing "any important matter." [86]

For nearly fifteen years the Commission has used its assortment of regulatory tools, whether formal, informal, or a mixture of both, to develop a cohesive policy with respect to the structure and functioning of the securities markets, a structure which in large measure had been shaped and affected by the rules of

[84] H.R. Rep. No. 1383, *supra,* p. 14.

[85] *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 353.

[86] H.R. Rep. No. 1383, *supra,* at p. 15.

exchanges requiring their members to charge the public fixed rates on exchange transactions.

What is at stake in the instant case, however, is not the Commission's substantive decision to eliminate the practice of fixed rates. None of the parties to this lawsuit formally disputes the propriety of such a conclusion under present circumstances. What is at stake is whether the governmental agency vested with continuing policy-making jurisdiction shall be permitted to establish national policy for the regulation of our nation's securities markets—"regulatory work for which [the Commission] was constituted . . . [and] which cries out for some rational plan" [87]—or whether that complex and delicate task shall be exercised through *ad hoc* decisions by the hundreds of district courts across this country.

But for the fact that not all of the determinations made by the Commission took the form of formal orders, the Department of Justice apparently would concur (DOJ Br. p. 48) that it is the Commission that should perform that policy-making function. The Department's limited concession, however, exalts form over substance. The Commission's authority to regulate the conduct of exchanges concerning commission rates is continuous and complete; it is the Commission, therefore, and not the antitrust courts, that most appropriately should serve as the "balance wheel," referred to by this Court in *Silver*,[88] to insure that, in

[87] *Stark* v. *New York Stock Exchange, Inc., supra*, 346 F. Supp. at 228.

[88] 373 U.S. at 367.

evaluating the conduct of exchanges, the public interest is fully and adequately protected.

The policy articulated by the Commission to eliminate fixed exchange commission rates was derived both from the cooperative relationship Congress intended the Commission to have with the exchanges, and from the contribution of views from interested members of the public, the Department of Justice, and others. Only by sustaining the decision of the court below can it be insured that the "partnership between government and private enterprise that marks the design of the Securities Exchange Act of 1934 can operate effectively . . . in the long run." [89]

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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MARCH 1975.

I authorize the filing of this brief.

ROBERT H. BORK,
Solicitor General.

[89] *Silver* v. *New York Stock Exchange, supra*, 373 U.S. at 366.

APPENDIX

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, are as follows:

NECESSITY FOR REGULATION AS PROVIDED IN THIS TITLE

SECTION 2. For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchange and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of inter-

state commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the

effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

* * * * *

TRANSACTIONS ON UNREGISTERED EXCHANGES

SECTION 5. It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 6 of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the

protection of investors to require such registration.

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SECTION 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are herein-

after collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member of conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this title shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this title and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as

a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

* * * * *

POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SECTION 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this title or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission

determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

* * * * *

The pertinent provisions of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, *et. seq.* are as follows:

SEC. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal: * * * Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

SEC. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be

deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

The pertinent provisions of the Clayton Act, 38 Stat. 731, 737, 15 U.S.C. 15, 26, are as follows:

SEC. 4. That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

SEC. 16. That any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections two, three, seven, and eight of this Act, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue: * * *

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No. 74-304

In the Supreme Court of the United States

OCTOBER TERM, 1974

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

DOCUMENTARY APPENDIX TO THE BRIEF FOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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S. 2693

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amendments to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

* * * * * *

SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Commission may fix or prescribe the method of fixing uni-

form rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance or primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

H.R. 7852

* * * * *

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amenndents to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

* * * * *

SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Com-

mission may fix or prescribe the method of fixing uniform rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance of primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

H.R. 8720

* * * * *

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents below specified:

(1) An undertaking to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder.

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange".

(4) An undertaking to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations made thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary, for the protection of investors, withdraw its registration.

* * * * *

DISCIPLINARY POWERS OVER EXCHANGES

SEC. 18. The Commission is authorized—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or an issuer of a security registered thereon;

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations made thereunder;

(3) After appropriate notice and opportunity for hearing by order to suspend for a period not exceeding twelve months or to expel altogether from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder or has effected any transaction for any other person who as he has reason to believe is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) If in its opinion the public interest so requires, summarily to suspend trading in any registered security for a period not exceeding ten days, and with the approval of the President, summarily to suspend trading upon any registered exchange for a period not exceeding ninety days.

(5) If after appropriate request in writing to a national securities exchange that such exchange should effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested and that such changes are necessary for the protection of investors or for the insuring of fair dealing in securities traded in upon such exchange or for the insuring of fair administration of such exchange, to alter or add to the rules, regulations, and practices of such exchange in respect of such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; hours of trading; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries by members and customers; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the

exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, in bankruptcy or receivership, and sales involving other special circumstances, the fixing of uniform rates of commission, interest and other charges; minimum units of trading; odd-lot purchases and sales, minimum deposits on margin accounts.

73D CONGRESS, 2D SESSION

S. 3420

[Report No. 792]

* * * * *

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments

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to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

* * * * *

DISCIPLINARY POWERS OVER EXCHANGES

SEC. 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such

transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with

the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

H.R. 9323

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing agreements, setting forth information, and accompanied by documents, as follows:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SEC. 18. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission shall find that such exchange shall have violated any provision of this Act or of the rules and regulations thereunder or shall have failed to enforce, so far as is within its power, compliance therewith by a member.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission shall find that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person whom he has reason to believe is violating in respect

of such transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or, with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) with respect to such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards with respect to the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; the making available, at appropriate times

and upon reasonable terms and conditions, of the names and addresses of holders of listed securities; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries, and of closing accounts; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; the fixing of rates of commission, interest, listing, and other charges; minimum units of trading; odd-lot purchases and sales; minimum deposits on margin accounts; and similar matters.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10206/June 6, 1973

The Securities and Exchange Commission announced that it has issued an order for the institution of an investigation and public investigatory hearing, pursuant to Section 21(a) of the Securities Exchange Act of 1934, to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules.

The Commission announced that it had received on May 31, 1973 from the New York Stock Exchange, Inc. proposed revisions of that exchange's present commission rate schedule as contained in Article XV, Section 2 of its constitution and of its Rule 383 regarding service to small investors. The May 31 submission from that exchange and the Commission's order are attached hereto.

The Exchange informed the Commission that it expects to submit a documented economic report in support of the proposed revisions within a week. That report will be available to all interested persons in the Public Reference Section, Room 100 at the Commission's Headquarters Office, 500 North Capitol Street, N.W., Washington, D.C. 20459 and at each of the Commission's regional offices. Persons who

wish to obtain a copy of that report may do so by writing to Dr. William C. Freund, Vice President and Chief Economist, New York Stock Exchange, Inc., Eleven Wall Street, New York, New York 10005.

It is the Commission's understanding that the NYSE's proposal to increase commission charges by 15% on orders from $5,000 up to $300,000 contemplates a 15% increase on the entirety of such orders rather than only on the portion of orders which exceeds $5,000. It is also the Commission's understanding that the proposed amendment to Rule 383 would enable member firms to charge small investors commissions in excess of the proposed 10% increase on orders involving from $100 to $5,000 or the proposed 15% increase on orders involving more than $5,000, i.e., the existing fixed commission on small investors' orders would become, as in the case of larger investors' orders, a minimum commission. Further, it would permit member firms to negotiate separate charges for other services rendered, such as custodial fees.

The Commission will also consider such other rule proposals as may be received from exchanges and, where appropriate, will issue a supplemental release describing them.

The Commission also announced that a public investigatory hearing on stock exchange commission rate proposals will convene at 10 a.m. Monday, July 9, 1973 at the Commission's headquarters, 500 North Capitol Street, N.W., Washington, D.C., to receive testimony and other relevant data on the foregoing NYSE commission rate proposals. The Commission has requested representatives of the NYSE to appear at that time to present testimony and relevant data and invites all other interested persons to submit their views. Persons who wish to appear and present fac-

tual material at the hearing are invited to notify the hearing officer (William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, N.W., Washington, D.C. 20549, (202) 755–1240) of that desire as soon as possible and not later than July 9, 1973.

Witnesses will be expected to file with the hearing officer 25 copies of their prepared statements 48 hours prior to their appearance and are invited to make available additional copies at the time of their appearance for the benefit of the press and other interested persons. Other interested persons may wish to transmit written submissions for inclusion in the record in lieu of personally appearing. They should file 25 copies thereof to facilitate examination of the record by all interested persons. Such material should be submitted not later than July 23, 1973. All other communications should be filed in triplicate.

By the Commission.

RONALD F. HUNT,
Secretary.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10383/September 11, 1973

CONCLUSIONS OF THE SECURITIES AND EXCHANGE COMMISSION WITH RESPECT TO COMMISSION RATES

The Securities and Exchange Commission announced today its unanimous conclusions concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW"), which were the subject of a recent public investigatory hearing.[1] Because of their importance to public investors, the national economy and the securities industry, the Comission has determined to announce its views immediately and publish shortly its letters to the exchanges embodying the reasons for its conclusions.

New York Stock Exchange Proposals

The NYSE has proposed to increase its fixed commission rates by 10 percent on orders ranging in size from $100 to $5,000, and by 15 percent on orders ranging in size from $5,001 to $300,000. The Commission today stated its conclusions that:

(1) It will not object if the NYSE immediately should adopt the proposed rate increase effective through March 31, 1974;

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[1] *See* Securities Exchange Act Release No. 10206 (June 6, 1973); Securities Exchange Act Release Nos. 10245 (June 28, 1973) and 10337 (Aug. 10, 1973).

(2) It will not object to the continuation of such a rate increase from April 1, 1974, through April 30, 1975, if the NYSE should first adopt rules, effective by or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule, and (b) permit, but do not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for discounts of up to 10 percent from the commission rate schedule referred to in subparagraph (1), above;

(3) It will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result; and

(4) It will not initiate in April, 1974, a break-point reduction below $300,000 respecting the portion of orders above which rates may be competitively determined.

PBW Stock Exchange Proposal

The PBW has proposed rule changes which would permit its members to offer investors a 14-day round-trip commission rate—that is, the grant of a 50 percent reduction in the commissions charged on the second transaction (either an offsetting sale or purchase) executed within 14 days of a purchase or a sale of the same security.[2] The Commission has concluded that it will object to the implementation of this round-trip commission rate proposal.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[2] *See* Securities Exchange Act Release No. 10245 (June 28, 1973).

SECURITIES EXCHANGE ACT

SECURITIES EXCHANGE ACT OF 1934

Release No. 10560/December 14, 1973

The Securities and Exchange Commission today announced that it had sent the following letter to James J. Needham, Chairman of the Board of Directors of the New York Stock Exchange, Inc., setting forth the reasons for the conclusions articulated by the Commission on September 11th with respect to, among other things, the New York Stock Exchange's proposal to increase their schedule of commission rates.

The text of the letter was as follows:

DECEMBER 14, 1973.

MR. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: On September 11, 1973, the Commission announced its views concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW").[1] At that time, the Commission stated that, because of the importance of its views to public investors, the national economy and the securities industry, the Commission had determined to announce its views immediately and subsequently to indicate the bases for them. This letter sets

[1] Securities Exchange Act Release No. 10383 (Sept. 11, 1973).

forth the reasons for the Commission's conclusions with respect to your exchange's proposal to increase commission rates and with respect to the more fundamental issue of the manner in which the commission rates charged by members of all national securities exchanges should be determined in the future.[2]

THE CONCLUSIONS EXPRESSED BY THE COMMISSION

The Commission, as you know, expressed five basic conclusions with respect to commission rates on September 11th:

(1) The Commission would not object if any national securities exchange should amend its rules immediately to increase its schedule of fixed commission rates member firms are required to charge their customers by 10 percent on orders up to $5,000 and by 15 percent on orders of more than $5,000, as had been proposed by the NYSE, nor to the continuation of those rates through March 31, 1974;

(2) The Commission will not object to the further continuation of those increased rates during the period from April 1, 1974, through April 30, 1975, by any stock exchange that adopts rules, effective on or before April 1, 1974, which

(a) eliminate that portion of NYSE Rule 383, or any comparable rule of another exchange, prohibiting member firms from charging their customers com-

[2] Although the NYSE was the only national securities exchange which formally proposed amendments to its rules designed to effect increases in its schedule of commission rate charges on the portion of all securities orders handled by exchange members not exceeding $300,000, others of the registered securities exchanges had advised us of their intention to effect increases in their commission rate schedules comparable to those proposed by the NYSE.

mission rates exceeding the exchange's commission rate schedule, and

(b) permit, but do not require, member firms to provide less than a full range of brokerage services furnished customers in return for discounts of up to 10 percent from the then effective commission rate schedule;

(3) The Commission will act promptly to terminate the fixing of commission rates by national stock exchanges after April 30, 1975, if the stock exchanges do not, on their own initiative, adopt rule changes achieving that result in advance of that date;

(4) The Commission will not, in April, 1974, initiate a breakpoint reduction below $300,000 respecting the portion of orders above which the commission rates charged by their members may be competitively determined; and

(5) The Commission expressed its disagreement with the PBW's proposal to permit its members to reduce commission rates by 50 percent on the second transaction (either an offsetting sale or purchase) executed within 14 days of a prior purchase or sale of the same security by the same person.

As noted above,[3] this letter sets forth some of the policies considered and formulated by the Commission with respect to the first four of the foregoing five conclusions articulated by the Commission on September 11, 1973, concerning commission rate schedules of national securities exchanges.

THE NYSE'S PROPOSAL TO RAISE ITS SCHEDULE OF MEMBER COMMISSION RATE CHARGES

In order to place the conclusions articulated by the Commission on September 11th in proper perspective,

[3] See p. 1, *supra*.

it is important to recognize the nature and regulatory context of the action the NYSE proposed to take.

The NYSE submitted to the Commission a proposed amendment to its rules designed to effect an increase in the commissions its members are required to charge their customers for the portion of those transactions effected on the exchange that do not exceed $300,000. This proposal had, as you are aware, been preceded by earlier NYSE proposals also designed to modify, in some manner, its rules fixing the level and rate of commissions charged by its members.

While Congress, in enacting the Securities Exchange Act in 1934, did not explicitly authorize exchanges to fix the rates of commissions their members could charge, it did implicitly recognize that national securities exchanges might fix the commissions their members are required to charge if this practice did not meet with Commission disapproval.[4] As is also true of other powers which may reside with the exchanges by virtue of the Securities Exchange Act, any power to adopt rules fixing commission rate charges is not an unfettered authority. First, the exchanges were not authorized to fix commission charges which are unreasonable. And second, Section 19(b)(9) of the Securities Exchange Act vests pervasive residual authority in the Securities and Exchange Commission to alter, modify or amend any rules or practices of exchanges fixing rates of commission and other charges, including their elimination, notwithstanding the apparent concern of

[4] Section 6(c) of the Securities Exchange Act, 15 U.S.C. 78f(c), authorizes an exchange to adopt "any rule not inconsistent with . . ." the Act or applicable state law. And Section 19(b)(9) of the Act, 15 U.S.C. 78s(b)(9), authorizes the Commission to alter, modify or amend any existing exchange rules fixing commission rates.

some members of Congress in 1934 that the Commission might abuse its authority over exchange rules fixing commission rates by causing those rates to be set too low.[5]

But, to the extent any such rules are appropriate, the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted.[6] The NYSE's rate proposal was submitted to us pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, generally requiring that advance notice be given to the Commission by any exchange proposing to amend its rules or practices. Our consideration of the NYSE's proposal was in the context of a determination whether the Commission should take any steps preliminary to the exercise of its authority concerning the effectiveness of the NYSE's proposed action.

We have considered the reasons why the NYSE proposed to increase the level of commission rates its members must charge, as well as the authority accorded to the exchanges by the Congress in 1934, and for the reasons enumerated below, we could not conclude that the NYSE's rate proposal was unreasonable.

In support of its proposal to raise commission rates, the NYSE provided the Commission with a substantial amount of information in support of the Ex-

[5] *See, e.g.*, the remarks of Congressman Pettengill during the House floor debates on the Securities Exchange Act:

"the Commission could fix rates of commission * * * so low that no broker could stay in business and thus [the Commission could] destroy his business * * *"

78 Cong. Rec. 8091 (1934).

[6] *See* pp. 8–10, *infra*.

change's position that member firms[7] have in the last 18 months experienced increases in the prices paid for goods and services.

The Exchange attempted to measure the effect of general inflationary forces and suggested specifically that substantial increases in the cost per transaction resulting from inflationary factors alone warranted a commission rate increase in the amount the Exchange had requested.[8]

The Commission recognizes that there has been some inflation in costs since the last increase effected

[7] Reference to the NYSE member firm community is not intended to indicate any failure to consider the circumstances of the members of other registered national securities exchanges. Indeed, the Commission has considered the fact that about 30 percent of all regional stock exchange member firms and over 80 percent of American Stock Exchange member firms also are NYSE member firms and believes that financial data concerning the NYSE firms for present purposes reasonably represents the financial experience of exchange members generally. And see note 2, *supra*.

[8] The Exchange submission included an attempt to measure the degree to which inflationary forces had increased the cost of brokerage firm payrolls and other goods and services purchased by member firms, proposing that the inflationary increase in costs experienced by member firms exceeded 17 percent between April, 1970, and April, 1973.

For example, exchange estimates of increases in the cost of specific items included a 19.1 percent increase in wages and salaries, a 55.9 percent increase in other employee benefits, a 15.2 percent increase in telephone and telegraph costs and an 8.7 percent increase in rental expenses.

The Commission is persuaded that significant cost increases have in fact occurred, whether or not the effect of such increases can be demonstrated to be in the precise degree suggested by the NYSE. Such increases, of course, must be, and in fact have been, considered along with other factors in determining whether or not the anticipated results of the proposed rate increase would be unreasonable.

by the Exchange in its schedule of commission rates and that Exchange members were not in a position to pass these increased costs on to their customers, largely because of the existing fixed rate schedule applicable to the vast bulk of orders executed on national securities exchanges. The Commission is also aware that, for a protracted period, there had been a substantial decline in the volume of transactions on exchanges which aggravated the effects of the cost increases that, in fact, had occurred.[9]

The Commission finds more significant, however, the Exchange's submission of information which clearly showed that its member firm community had been experiencing severe financial losses for a substantial period preceding the rate request.

Although the profitability of NYSE member firms carrying public customer accounts, in terms of pre-tax rate of return on capital and in terms of profit margin (pre-tax return as a percentage of gross revenue) were 18.9 percent and 12.8 percent, respectively, for the full year of 1972, rates of return in the last half of 1972 had declined below their historical average levels.[10] For the first seven months of 1973, NYSE

[9] In the second quarter of 1973, the value of trading on the NYSE had declined to a level 18 percent below the level of the same period in 1972. On the AMEX, the value of trading had declined 62 percent over the same period. In the first eight months of 1973, the value of trading was down 13.2 percent on the NYSE and 55.9 percent on the AMEX from the comparable period in 1972.

[10] These data are based upon the unconsolidated pre-tax profit figures reported by such firms on their Joint Regulatory Report, a monthly report the NYSE requires its members to file with it. Data are available on a consolidated basis for the years 1965 through 1972 from the annual income and expense reports filed by NYSE member firms carrying public customer accounts.

member firms doing a public business [11] as a group, suffered pre-tax losses of $195 million on total securities activity.

This decline in profitability in the last half of 1972 and loss condition in the first seven months of 1973 was apparently experienced by firms of all types, whether regional or national, and whether serving primarily large investors or primarily small investors. Not only was there an indication that roughly one-half of the NYSE firms which carried public customer accounts were suffering such severe losses, it was also clear that, if the same level of losses that had occurred in early 1973 continued, in less than twelve months seventy-six of these firms would be unable to meet the requisite net capital requirements for doing business.

Thus, on the basis of the financial experience of the industry in late 1972, and the first seven months of 1973, it did not appear that unreasonable rates of return were likely to result if the proposed rate increase were effected by the NYSE. On the other hand, without the rate increase, the continued deterioration in the capital positions of many member firms was foreseeable, with significant capital impairment and indirect, but consequential, harm to investors the likely result.

These circumstances principally motivated the Commission to raise no objection to the NYSE's rate increase for the period ending March 31, 1974.

THE MOVE TO UNFIXED COMMISSION RATES

The Commission's conclusion that it would be appropriate to require exchanges to eliminate fixed commission rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate increase proposed by the NYSE.

[11] This includes both firms carrying public customer accounts and introducing firms.

The Commission has consistently taken the position that the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature.[12]

The Commission does not, however, view this letter as the appropriate place to articulate definitively the reasons for its conclusion that the fixing of commission rates on securities transactions should be termi-

[12] In this context, it should be noted that Senator Harrison A. Williams, Jr., Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, in his July 27, 1973, statement submitted to the Commission in its recent hearings on the NYSE's rate proposal, suggested:

"* * * that the Commission used the present public proceeding to establish a blueprint for totally eliminating fixed brokerage rates. The Commission should announce a definite date for the end of price-fixing. The date should be sufficiently distant to allow the industry to adjust and plan adequately for a competitive environment, but it should be near enough to furnish the industry, the self-regulatory organizations and the Commission with the impetus to concentrate on and pursue measures

nated by April 30, 1975. Should it become necessary for the Commission to request Exchange action in the manner prescribed by Section 19(b) of the Securities Exchange Act, however, the Commission will set forth the basis upon which it is, at that time, requesting that specified action be taken.[13]

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which hold the promise of substantially reducing costs and improving the efficiency of broker-dealer operations. Suggestions for setting such a date 12 to 18 months hence, appear to me to be reasonable.

"In the event the Commission adopts the approach I am recommending, I believe it would be entirely appropriate for it to consider increasing fixed rates during the interim period. In light of the apparently severe profit squeeze in the industry such a rate increase may well be appropriate in the public interest."

[13] The Commission is aware of the present significance to the exchanges and their member firms of its view that fixed rates be abolished. For this reason, and in order to aid the exchanges in the formulation of appropriate rules, the exchanges should be aware of the following factors which have influenced the Commission's conclusion:

(1) The Commission is concerned that the heterogeneous nature of the brokerage industry militates against applying one fixed commission rate schedule to all elements in the industry.

(2) The Commission believes that, even without fixed minimum commission rates, the advantages of best execution for customer orders and the convenience and benefits, both to brokers and customers, of clearance and other services will cause trades to be brought to the exchange market. In any event, however, the Commission is satisfied that it has the authority necessary to assure that abandonment of exchange membership is not a means to evade the investor protection obligations incident to exchange membership.

(3) The Commisson has substantial doubt whether, in fact, small investors' transactions are subsidized by fixed commission charges to institutional investors, to the extent this is suggested as a rationale for the maintenance of fixed rates.

(4) The Commission is not persuaded, as some members of the industry apparently are, that fully competitive rates would result in large firms forcing small firms out of business; small regionally-located firms have disagreed.

PREDICATES FOR THE EXTENSION OF AN INCREASE IN FIXED COMMISSION RATES FROM APRIL, 1974 THROUGH APRIL, 1975

In its release issued on September 11th, the Commission indicated its view that it would not object to the further continuation—for the period from April 1, 1974, through April 30, 1975—of the increase in Commission rates proposed by the NYSE, if the NYSE should first effect changes in its rules designed to permit an interim period during which member firms could both (1) charge up to 10 percent less than the exchange-fixed minimum rate schedule if they should provide less than the full range of brokerage services generally being furnished at the present time, and (2) charge more than the exchange-fixed minimum rate schedule if they believe such increased charges are appropriate.

We understand through conversations with representatives of the exchanges and the member firm community that there is some question whether the foregoing proposal represents a workable opportunity for experimentation with limited price competition. We adhere, however, to our objective that the exchanges take steps to effect a meaningful experimental period prior to the introduction of a system of completely unfixed commission rates, even if it should take the form of a modification of our proposal or some other realistic alternative to it. We believe the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during this period prior to the introduction of unfixed rates if there is a desire to retain the commission rate increase that was the subject of our September 11th release beyond April 1, 1974, and we request timely initiatives by the exchanges and

other interested persons to effect this aspect of the Commission's September 11th conclusions.

LACK OF ANY NEED FOR FURTHER REDUCTIONS IN THE BREAKPOINT AT WHICH MEMBER FIRMS MAY NEGOTIATE COMMISSION CHARGES

The Commission heretofore has encouraged a program of phased reductions of the breakpoint above which member firms may competitively determine commission rate charges. The volume discounts effected by the several exchanges since 1968 at the Commission's suggestion, as well as the phased introduction of competitively-determined rates on the portion of all stock exchange orders exceeding $300,000, certainly have effected necessary changes in the exchange-fixed commission rate structure which had created certain distortions in trading activities. These changes, however, were dispositive of a number of problems raised by larger firms or institutional investors. With the experiment in limited price competition that we hope all exchanges will effect, other investors, not merely those with large orders, will have the opportunity to react to the limited range of competitive rates this next step can provide. Accordingly, the Commission has concluded that it is not necessary to initiate an April, 1974, competitive rate breakpoint reduction to a point below $300,000.

For the reasons discussed above, the Commission believes that the rate increase of limited duration, and the phasing-in of competitively determined rates during the transitional period beginning by April 1, 1974, we envision, will assist in achieving a market structure and commission rates that will better serve the interests of investors, the broker-dealer community, stock exchanges and the issuers whose securities are

traded thereon. We expect, in the spirit of cooperation that is vital to the viability of any regulatory program, that your exchange, as well as the other national securities exchanges, will timely initiate rule changes consistent with the views expressed in this letter and in our release of September 11th, 1973. We look forward to working with the NYSE and all other interested persons to achieve these ends.

For the Commission,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10670/March 7, 1974

ANNOUNCEMENT IN RESPONSE TO COMMISSION RATE PROPOSALS

The Commission announced today that it has responded to the New York Stock Exchange's proposals to initiate a program for limited price competition commencing April 1, 1974 on non-member orders involving up to $2,000 and to rescind existing prohibitions against charging, on orders involving more than $2,000, commissions in excess of the rates provided in stock exchange commission schedules. Further, the Commission responded to an NYSE request that minimum intra-member rates for floor brokerage and clearance functions be retained on orders not exceeding $2,000 and that a public investigation be made of the likely effects of introducing intra-member competitive rates for execution and clearance. The Commission stated that pending further study of, and solicitation of the public's views and comments on, whether current rules fixing intramember rate charges prevent an adequate experiment with limited price competition, it would not object to implementation, by April 1, 1974, of the limited unfixing of non-member rates described above. The text of the Commission's letter follows:

Mr. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: This is in response to the letters of the New York Stock Exchange ("NYSE"), dated February 7 and 21, 1974, which submitted to us, pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, proposed amendments to the NYSE's Constitution and Rules respecting commission rates. These letters responded to the statement in our letter of December 14, 1973, to the NYSE, that "the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during "the period between April 1, 1974, and April 30, 1975. Accordingly, the NYSE's February 7th letter proposed amendments to Article XV of its Constitution, which would:

(1) provide for competitive non-member and intramember commission rates on all orders not exceeding $2,000; (2) rescind the prohibition now set forth in NYSE Rule 383 against charging commissions exceeding the existing exchange schedule of minimum rates applicable to orders exceeding $2,000; and (3) otherwise rescind NYSE Rule 383.

In its letter of February 21, the NYSE modified its original suggestions for Constitutional and Rule changes by deleting its proposed amendments respecting intramember rates for floor brokerage and clearance functions on orders not exceeding $2,000 (Sections 2(b) and 2(c) of Article XV of the NYSE Constitution). In this regard, the NYSE stated that no study has been made of the likely effects of intramember competitive rates and requested the Commission to conduct an investigation of this matter.

Pending further study of, and solicitation of the public's views and comments on, the question whether

the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and consitutional changes.

The Commission appreciates the NYSE's timely efforts to begin a constructive experiment with limited price competition on April 1, 1974.

Sincerely,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10751/April 23, 1974

NOTICE OF PUBLIC HEARING ON INTRA-MEMBER COMMISSION RATE SCHEDULES OF REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that a public investigatory hearing, ordered pursuant to the Commission's authority under the Securities Exchange Act of 1934 ("Exchange Act"), including, but not limited to, Exchange Act Section 21(a), 15 U.S.C. Section 78u(a), will be held beginning May 29, 1974 to receive oral and written comments, views and data concerning whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges prescribing minimum rates of commission for business performed by one member for another ("intra-member rates"). The hearing will convene at 10 a.m., Wednesday, May 29, 1974, in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

In Exchange Act Release No. 10383 (September 11, 1973), the Commission announced its determination not to object to the proposal of the New York Stock Exchange, Inc. ("NYSE") to increase by 10 percent its fixed commission rates on non-member orders ranging in size from $100 to $5,000, and by 15 percent

on non-member orders ranging in size from $5,001 to $300,000. The Commission also announced in that Release that it would initiate action to terminate the fixing of commission rates by securities exchanges after April 30, 1975 if the exchanges have not amended their rules to effect such termination by that date and that, in order for the rate increase to continue from April 1, 1974 through April 30, 1975, the NYSE should adopt a program of rule changes, effective on or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule and (b) permit members to engage in a limited but adequate experiment in competitive commission rates. These conclusions were applied also to every exchange which adopted, and desired to continue in effect, the 10 percent and 15 percent commission rate increases. In Exchange Act Release No. 10560 (December 14, 1973), the Commission requested the exchanges to initiate timely development of such a program of rule changes.

In a letter dated February 7, 1974, the NYSE submitted to the Commission proposed amendments to its constitution and rules to rescind Rule 383, to provide for competitive commissions on both member and non-member orders of $2,000 or less and to rescind the prohibiton against charging commissions exceeding minimum rates. By letter dated February 21, 1974, the NYSE modified its proposal by withdrawing those of its proposed amendments which would have subjected intra-member commission rates to competition on orders of $2,000 or less.

In its letter, the NYSE also stated the following:

> The Exchange does not believe, however, that it is necessary to amend those provisions of the Constitution dealing with floor brokerage and clearance (Article XV, Sections 2(b) and 2(c)) in order to provide the experimentation sought by the Commission in its letter of December 14, 1973. No study has been made of the likely impact in the intra-member competitive rates, but quite clearly this impact might be unexpectedly severe on those members and member organizations which are largely dependent on these floor brokerage and clearance rates. A serious erosion in floor brokerage income could have a harmful impact on the essential market making function of specialists.
>
> The Board of Directors is not aware that there has been any meaningful accumulation of data on an industry wide basis as to the possible impact of negotiated intra-member rates. Because of the importance of this question with regard to the restructuring of the industry, the Board of Directors urges the Commission to conduct a public investigation of this matter pursuant to Section 21 of the Securities Exchange Act of 1934. This procedure would enable all interested parties to be heard and should provide the essential information needed to make an appropriate determination of this question. The Board urges that this procedure be initiated promptly so that it be completed well in advance of April 30, 1975.

In Securities Exchange Act Release No. 10670 (March 7, 1974), the Commission responded to the NYSE's modified proposals, stating:

> Pending further study of, and solicitation of the public's views and comments on, the question whether the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth

in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and constitutional changes.

Somewhat similar statements respecting intra-member rates were received from, and corresponding replies were sent to, other stock exchanges in connection with their proposals to implement, by April 1, 1974, the same limited experiment in competitive commission rates.

Interested persons who desire to appear or to submit written comments, views or data in this matter may wish to review materials submitted in the investigatory hearings conducted by the Commission in 1970 and 1971 concerning the reasonableness of, and the need for, minimum intra-member rates. These materials are contained in the following documents, which are available for inspection in the Commission's Public Reference Section, Room #6101, 1100 "L" Street, N.W., Washington, D.C. 20005 (copies of the hearing transcripts listed below may also be available in the Commission's regional offices):

Hearing Transcripts

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–17, July 20, 1970, Pages 5996–6037;
File No. 4–144–1–18, July 21, 1970, Pages 6188–6199 and Pages 6205–6208;
File No. 4–144–1–22, July 12, 1971, Pages 7279–7295;
File No. 4–144–1–22, July 13, 1971, Pages 7551–7586 and Pages 7594–7597; and

File No. 4–144–1–22, July 14, 1971, Pages 7599–7606 and Pages 7622–7625.

Exhibits

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–10 (NYSE). Exhibit 29–A—"Report on New Commission Rate Schedule" dated July 13, 1970, Pages 19–20.
File No. 4–144–1–14 (NYSE). Exhibit 71–1—"Report on New Minimum Commission Rate Schedule" dated July 12, 1971, Pages 21–26.

The purpose of the hearing is to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission. It will be necessary, if such schedules of intra-member rates are to be retained, for the Commission to have a basis upon which to judge the reasonableness of such rates. The following questions are intended to elicit such information. Persons who wish to offer oral or written statements for the record of the hearings are invited to comment on the following questions and other matters related to intra-member rates.

(1) What reason is there to conclude that an experiment until April 30, 1975 in competitive intra-member rates for orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists? If members without their own floor brokers ("off-

floor members") are competitively disadvantaged as against vertically-integrated members (*i.e.*, members having their own floor brokers) by the present fixing of intra-member rates (see question (12)), will permitting fixed intra-member rates on orders not exceeding $2,000 during the period of experimentation with competitive non-member rates on such transactions, exacerbate the competitive disadvantage of off-floor members or, as between off-floor members and vertically-integrated members, cause statistically biased results respecting competitive non-member rates?

(2) Are intra-member rate schedules for (a) clearance services or (b) floor brokerage services necessary or appropriate for the protection of investors, or to insure fair dealing in securities traded upon an exchange, or to insure fair administration of an exchange?

(3) Assuming it is necessary or appropriate to have intra-member rate schedules for clearance functions, should such rates be higher than the clearing fees charged by a clearing corporation for direct mail clearance? Should they be different for orders effected for the member's own account than for orders effected by such member for other persons? (Compare Sections 2(b) and 4 of Art. XV of the NYSE Constitution.)

(4) Should intra-member rate schedules for execution be applicable to

(a) orders left with specialist (or, in the case of the Chicago Board Options Exchange, board brokers),

(b) services provided by a floor broker not acting as a specialist, or

(c) both?

(5) Should intra-member rate schedules for floor brokerage be different for different types of orders

(*e.g.*, market orders, limited price orders, percentage orders, not-held orders)?

(6) Should a member who provides execution and clearance services for other members and for non-member brokers be prohibited from lowering its prices if it believes such action is necessary to retain the business it receives from correspondents?

(7) Assuming it is necessary or appropriate for exchanges to retain intra-member rate schedules for floor brokerage, what standards should be used to determine their reasonableness? Please answer the following questions separately for (a) floor brokers not acting as specialists and (b) specialists, and explain whether your answers would differ depending on whether the intra-member rate schedules would provide for a minimum rate with no maximum, a fixed rate which is both a minimum and a maximum, or a maximum rate with no minimum:

(i) What expenses should be allowable in determining floor brokerage rates?

(ii) Should rate of return on investment be the standard used to determine the reasonableness of levels of profitability? If so, what should be the base of the rate of return, *i.e.*, equity capital or equity and debt capital?

(iii) What rate(s) of return should be allowed?

(iv) In order to provide excess floor brokerage capacity (if that is needed), must rates for floor brokerage be more than "economic cost-remunerative" (cover more than costs plus reasonable profit), or, absent such subsidy, would the number of available floor brokers increase quickly enough to accommodate sudden increases in demand? If excess capacity for floor brokerage services is needed, how much is needed and can it be supplied at lower cost by the automation of certain types of orders?

(v) Do intra-member rate schedules for floor brokerage which are more than economic cost-remunerative, or which compensate for maintaining excess capacity, unduly inhibit the automation of floor brokerage services?

(vi) Can costs and capital of non-specialist floor brokers be allocated among agency activities and their other activities? If so, how? If a member engages generally in the securities business in addition to providing floor brokerage services, should costs and capital be allocated between floor brokerage done for that member's own organization and that done for other member organizations?

(vii) Can costs and capital of specialists be allocated among specialists' broker functions, dealer functions and their other activities?

(viii) Should the standards for measuring the reasonableness of costs and rates of return differ in formulating intra-member rate schedules for specialists and for floor brokers?

(8) If exchanges are to retain schedules of intra-member rates of commission for specialists,

(a) should the specialist receive all or part of the intra-member rate for floor brokerage when he acts as broker with respect to an order left on his book? (Compare NYSE Constitution Art. XV, Section 2(c), which provides for payment of the full intra-member floor brokerage rate on that exchange to the specialist when he acts as broker for an order left with him, and American Stock Exchange, Inc. ("Amex") Constitution Art. VI, Section 2(c), which provides under similar circumstances for payment of approximately ¾ of the intra-member rate for floor brokerage to the specialist, leaving approximately ¼ for retention by the floor broker.)

(b) should the answer to (a) differ if the specialist acts as dealer with respect to such an order? (Compare the above NYSE and Amex constitutional provisions with Midwest Stock Exchange Article XXVIII, Rule 22.)

(9) Should intra-member rates paid to specialists on orders left with them be more than economic cost-remunerative in order to subsidize the specialist's dealer obligation? If so, can the amount of subsidy be calculated (and periodically adjusted) to do no more than subsidize the dealer obligation to the extent such a subsidy is required?

(10) (a) Assuming that the quality of specialists' dealer performance *can* be objectively evaluated,

(i) should floor brokerage income from the execution of orders left with all specialists on an exchange be pooled and then allocated by the exchange to specialists on the basis of performance?

(ii) if there is no pooling of floor brokerage income, should an exchange structure its schedule of rates so that a high-rated specialist would receive a larger portion of the floor brokerage income from orders left with him than he would if he were low-rated?

(iii) if there is no pooling of floor brokerage income and no differentiation in the amounts paid to specialists on the basis of their ratings, should an exchange reallocate stocks among specialists from time to time to reinforce high standards of specialist performance?

(iv) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks, take into account a specialist's profitability, or lack thereof, in addition to his dealer performance rating?

(v) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks be designed to achieve a subsidy of specialists' dealer activity in less profitable stocks?

(b) Could a prescribed intra-member rate for specialists' floor brokerage services which included an amount intended to subsidize the specialists' dealer functions meet the test of reasonableness if the quality of specialists' dealer performance *cannot* be objectively evaluated?

(11)(a) Does assignment by an exchange of the book to one specialist confer an undue competitive advantage upon him over other market makers on and off such exchange who would be willing to share the specialist's dealer obligations if they participated in his subsidy?

(b) If liquidity with depth is provided by competing market makers on or off an exchange (other than the exchange specialist) and the exchange retains intra-member rates for specialists which include a subsidy,

(i) should provision be made for such other market makers to receive a portion of the subsidy, and should the answer depend upon whether they supply such liquidity with depth for competitive reasons, or pursuant to their assumption of affirmative obligations; or

(ii) should each such market maker (including the specialist) have his own book and corresponding subsidy? If so, under what conditions?

(12) Do intra-member rates which are more than economic cost-remunerative place off-floor members at a competitive disadvantage as against vertically-integrated members? If intra-member rates on limit orders

left with specialists are not to be merely economic cost-remunerative but, as a matter of policy, are to include a subsidy for the specialist's market-making function, can intra-member rates for floor brokerage be the same for floor brokers as for specialists without competitively disadvantaging off-floor members?

(13) Assuming that the specialist's dealer function should be subsidized through intra-member rates on orders left with specialists and that excess floor brokerage capacity should be subsidized through separate intra-member rates for floor brokerage, will each of these assumed needs result in identical intra-member rates for specialists' agency sevices and for floor brokers' services? If the two have different costs or capital requirements, should exchange-mandated intra-member rates for agency services nevertheless be the same? If the intra-member were to be different for agency services provided by specialists and floor brokers, or were to be prescribed in the case of one but not the other, would this produce results inconsistent with the protection of investors, fair dealing or fair administration of the exchange?

(14) Various securities exchanges impose charges and fees, payable by one member to another member, for services other than traditional floor brokerage and clearance. For example, when a market-maker member on the PBW Stock Exchange, Inc. effects a principal transaction in one of the stocks in which he is registered with that exchange as an alternate specialist, he must pay 1¢ per share to the regular specialist in that stock (Rule 459). On the Midwest Stock Exchange, Incorporated a member (who is not a specialist) who deals as principal with another member is entitled to receive from that other member a fee equal to the rate of floor brokerage (Art. XXVIII, Rule 22). Are such required fees and charges necessary or appropri-

ate? What standards should be used to determine the reasonableness of such fees and charges?

Persons who wish to appear at the hearing are requested to notify the hearing officer, William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1240, as soon as possible.

Persons intending to appear should file 25 copies of the text of their prepared oral statements with the hearing officer 48 hours prior to their appearance and are invited to make additional copies of their statements available at the time of their appearance for the benefit of the press and all other interested persons.

Persons wishing to submit written statements for the Commission's consideration, in lieu of appearing personally, should file 25 copies thereof no later than June 14, 1974.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10986/Aug. 27, 1974

ANNOUNCEMENT OF PLANS TO EFFECT THE ELIMINATION OF RULES OF NATIONAL STOCK EXCHANGES FIXING COMMISSION RATES

The Securities and Exchange Commission today announced that it plans promptly to initiate steps concerning the amendment, modification, alteration or repeal of the existing rules and practices of the national securities exchanges registered with the Commission pursuant to Section 6 of the Securities Exchange Act of 1934,[1] requiring exchange members to charge fixed rates of commission on securities transactions effected on exchanges.

The Commission is issuing this release in view of the questions that have been raised concerning the procedures to be followed by the Commission and the national securities exchanges in this regard.

On September 11, 1973,[2] the Commission announced its policy conclusion that exchange rules and practices requiring members to charge fixed rates of commission on securities transactions effected on an ex-

[1] 15 U.S.C. 78f.

[2] *See* Securities Exchange Act Release No. 10383.

change should be eliminated.[3] In its announcement, the Commission expressed its view that the elimination of such rules and practices should be effective no later than May 1, 1975.

In this context, the Commission today announced that, pursuant to the authority vested in it under the Securities Exchange Act, and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[4] it would send a letter to the president of each national stock exchange during September, 1974, asking them to alter, amend or modify existing exchange rules and practices which presently require, or have the effect of requiring, their members to charge fixed rates of commission, unless action on their part should make this unnecessary.

In the event that any or all of the exchanges decline to take such action voluntarily, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to effect modifications, alterations or amendments in existing exchange rules and practices relating to the fixing of commission rates.

The Commission's prior discussion of its views indicated its preference for voluntary exchange efforts to achieve a system of unfixed commission rates. Nevertheless, the Commission recognizes that there may be differences of view concerning whether, how and when to achieve such a system of unfixed commission rates on exchange transactions. For that reason, unless exchanges voluntarily take prompt steps to eliminate fixed commission rates, the Commission

[3] Further elaboration of the policy considerations underlying the Commission's determinations with respect to exchange rules and policies requiring members to charge fixed commission rates is set forth in Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[4] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

intends to afford all interested persons an opportunity to submit both written and oral data and views in order to facilitate a thorough consideration of this issue. In light of the prior study that has been given to the question of eliminating the present structure of fixed commission rates for securities transactions effected on exchanges,[5] however, it is the Commission's intention expeditiously to conclude any hearings which may be required.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[5] Since 1968, the Commission and the Congress have expended a great deal of time and effort in studying the structure of commission rate charges on exchange-effected securities transactions. *See, e.g., In the Matter of SEC Rate Structure Investigation of National Securities Exchanges*, Commission File No. 4–144 (1968–1971); Subcommittee on Commerce and Finance of the House of Representatives Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. *Securities Industry Study*, Parts 1–9 (1971–1972); Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 1st and 2d Sess., *Securities Industry Study* (1971–1972).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11019/September 19, 1974

ANNOUNCEMENT OF WRITTEN REQUESTS CONCERNING COMMISSION RATES SENT TO REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that it had sent the following letter to all registered national securities exchanges:

DEAR [PRESIDENT OF EACH REGISTERED NATIONAL SECURITIES EXCHANGE]: As you are aware, the Commission, on September 11, 1973,[1] announced its policy conclusion that the fixing of commission rates by national securities exchanges should terminate after April 30, 1975. This conclusion followed ten years of special studies, Commission public investigatory hearings and policy statements, Congressional hearings and reports, studies by consultants for the New York Stock Exchange and publications by scholars concerning this practice.[2]

[1] *See* Securities Exchange Act Release No. 10383. The Commission's policy conclusions were discussed in more detail in a separate letter to the New York Stock Exchange, reprinted as Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[2] *See, e.g.*, Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971); Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963); Securities and Exchange Commission, *Report on the Public Policy Implications of Investment*

The Commission, however, has consistently taken the position that the long history of fixed rates argued against a precipitate elimination of the fixed rate sys-

Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966); and Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–171; *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147; *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144.

See Securities and Exchange Commission, *Policy Statement on the Structure of a Central Market System* (1973); and Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (1972).

See, e.g., Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess. *Report of the Securities Industry Study*, S. Doc. No. 93–13 (1973); Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., *Report of the Securities Industry Study for the Period Ending February 4, 1972* (1972); *Hearings on Securities Industry Study Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong., 1st Sess. (1972); Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess., *Report of the Securities Industry Study* (1971–1972).

National Economic Research Associates, Inc., *Stock Brokerage Commissions: The Development and Application of Standards of Reasonableness for Public Rates. A Report to the Cost and Revenue Committee of the New York Stock Exchange* (July 1970); National Economic Research Associates, Inc., *Reasonable Public Rates for Brokerage Commissions, A Report to the Cost and Revenue Committee of the New York Stock Exchange* (Feb. 1970).

See, e.g., Friend and Blume, *The Consequences of Competitive Commissions on the New York Stock Exchange* (1972).

tem and that it was appropriate, therefore, for the protection of investors and in the public interest, that exchange members be given an opportunity to develop business strategies for, and to adjust their operations to, an unfixed rate environment.

That opportunity has been provided. Commission schedules of exchanges have provided for volume discounts since December, 1968.[3] Commissions on portions of orders exceeding $500,000 have been competitively determined since April, 1971,[4] and those exceeding $300,000 have been competitively determined since April, 1972,[5] and, those with respect to nonmember commissions on orders of $2,000 or less, since April, 1974.[6]

Subsequent to the Commission's announcement of its policy conclusions on September 11, 1973, and in response to a request from the New York Stock Exchange, Inc., the Commission held a public investigatory hearing concerning fixed intramember rates on exchanges.[7] The Commission is not persuaded, on the basis of the data and views obtained as a result of that hearing and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intramember rates. The Commission has also determined not to exercise its authority to require any further experimentation with unfixed intra-member rates prior to May 1, 1975. It will, however, welcome any initiative by any exchange to provide additional experimentation on floor brokerage rates prior to April 30, 1975.[8]

[3] *See* Securities Exchange Act Release Nos. 8324 (May 28, 1968), and 8399 (Sept. 4, 1968).

[4] *See* Securities Exchange Act Release Nos. 9105 (Mar. 11, 1971) and 9132 (Apr. 1, 1971).

[5] *See* Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, *supra* n. 2, at p. 16.

[6] *See* Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[7] *See In the Matter of Intra-Member Commission Rate Schedule of Registered National Securities Exchanges*, *supra* n. 2.

As a result of these studies and hearings, it presently appears to the Commission that it is necessary and appropriate (1) for the protection of investors, (2) to insure fair dealing in securities traded in upon national securities exchanges, and (3) to insure the fair administration of such exchanges, that the rules and practices of such exchanges that require, or have the effect of requiring, exchange members to charge any person fixed minimum rates of commission, should be eliminated. Accordingly, the Commission hereby formally requests, pursuant to the authority vested in it under the Securities Exchange Act of 1934, and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder,[9] that you effect necessary changes in the Constitution, rules and practices of your exchange which presently require, or have the effect of requiring, any member of your exchange to charge any person any fixed commission rate, with such changes to be effective on or before May 1, 1975.

Because we believe the interests of public investors require the prompt implementation of the above-described Constitutional, rule and practice changes, we request that your Board of Directors approve the requested changes no later than November 1, 1974,

[8] The Commission will act promptly on any submission by the New York Stock Exchange of the proposal, discussed in the course of our Intra-Member Rate Hearings, n. 2, *supra*, to eliminate fixed minimum commission rates for clearance (Sections 2(b) and 4, Article XV, of the NYSE Constitution).

[9] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

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with such changes to become effective, after appropriate exchange procedures, not later than May 1, 1975. If the boards of directors of all of the national securities exchanges registered with the Commission do not take such action on or before November 1, 1974, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to alter or amend the Constitutions, rules and practices of such exchanges in the manner described above. In that event, as you previously have been advised,[10] the Commission will afford you and other interested persons an opportunity to submit both written and oral data and views in order to facilitate the Commission's consideration of whether to exercise its authority in this matter and whether to exercise it in the manner specified above. The procedures for that purpose would be specified prior to the commencement of any such proceeding.

For the Commission.

Sincerely,

RAY GARRETT, JR.,
Chairman.

The letters were sent to the American Stock Exchange, Inc., Boston Stock Exchange, Chicago Board Options Exchange, Inc., Chicago Board of Trade, Cincinnati Stock Exchange, Detroit Stock Exchange, Midwest Stock Exchange, Inc., National Stock Exchange, New York Stock Exchange, Inc., Pacific Stock Exchange, Inc., PBW Stock Exchange, Inc., Intermountain Stock Exchange and Spokane Stock Exchange.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[10] *See* Securities Exchange Act Release No. 10986 (Aug. 27, 1974).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11073/October 24, 1974

PROPOSAL TO ADOPT SECURITIES EXCHANGE ACT RULES 19B–3 AND 10B–22 (4–176)

The Securities and Exchange Commission today released for public comment proposed Securities Exchange Act Rules 19b–3 and 10b–22. The rules would be adopted under the Securities Exchange Act of 1934 (the "Act"), and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder, 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w. In that connection, the Commission also announced that it would hold oral hearings beginning Tuesday, November 19, 1974, at 10 a.m., in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

Introduction

On September 19, 1974, the Commission requested national securities echanges to effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that require, or have the effect of requiring, exchange members to charge any person any fixed rate of commission.[1] While the Commission has not received responses from all na-

[1] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974).

tional securities exchanges, only one such exchange has indicated that it would comply with the Commission's request,[2] and three such exchanges have indicated that they do not intend to comply fully with the Commission's request.[3] Accordingly, the Commission has determined to publish for comment proposed Rule 19b–3 which would alter and supplement the rules of national securities exchanges by prohibiting national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge

[2] The Intermountain Stock Exchange has so indicated; in addition, while the Cincinnati Stock Exchange has not yet responded to the Commission's request, it took action in July, 1974, to eliminate fixed intra-member rates.

[3] The American, Boston and New York Stock Exchanges have so indicated. The Amex has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The NYSE has indicated that it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has, therefore, indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. It has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

any person any fixed rate of commission for transactions executed on, or effected by use of the facilities of, such exchanges. In addition, Rule 19b–3 would require exchanges to provide in their rules that nothing therein or in the practices of exchanges shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission. Rule 19b–3 would also relieve exchange members and their associated persons of the obligation to comply with any exchange rule covered by paragraph (a) of Rule 19b–3 regardless of whether the exchange had amended or repealed such rule; members and associated persons could also no longer rely on such an exchange rule.

In addition, the Commission has determined to publish for comment proposed Rule 10b–22 which would make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange. Proposed Rule 10b–22 would, however, not affect participation in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8. Under section (c) of the proposed rule, the Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, could grant exemptions, either upon written request or upon its own motion, and could impose upon any exemption so granted such terms and conditions as it deemed necessary or ap-

propriate in the public interest or for the protection of investors. Proposed Rule 10b–22 is intended to prevent circumvention of proposed Rule 19b–3 and, accordingly, would only be adopted if proposed Rule 19b–3 is adopted.

Commission concern with the operation of rules prescribing fixed commission rates for exchange transactions spans more than a decade of hearings and studies;[4] transitional changes in the historical fixed commission rate structure began in 1968[5] and have continued over a period of six years, reflecting the Commission's determination to devise gradual solutions which would be consistent with the protection of investors and the public interest; and the Commission's policy conclusions to act to terminate the fixing of commission rates have been a matter of public record for more than a year.[6] Nevertheless, before adopting rules to eliminate the fixing of commission rates, the Commission is undertaking to review all issues involved (including issues relating to the third market and such other issues as the exchanges and other interested persons believe should be covered) as well as to consider carefully any collateral consequences that might result from the elimination of fixed rates. Furthermore, it may be appropriate to consider

[4] Materials relating to such hearings and studies, as well as some of the other source materials which may prove useful to interested persons in submitting views, data and arguments with respect to the rules proposed today are listed, *infra*. The Commission will make available shortly a synopsis of action previously taken by the Commission relating to fixed commission rates on exchange transactions.

[5] *See* Securities Exchange Act Releases Nos. 8324 (May 28, 1968) and 8399 (Sept. 4, 1968).

[6] *See* Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973).

whether alternative or additional regulations should be provided under the Act.

Therefore, in addition to soliciting the submission by interested persons of written views, data and arguments, which should be submitted no later than December 10, 1974, the Commission will hold oral hearings beginning on November 19, 1974, to obtain oral presentations of views and data and arguments. The Commission will invite representatives of the national securities exchanges, member firms and other organizations in the securities industry as well as other interested persons to appear at the oral hearings. The Commission will welcome requests from other persons to appear and, subject to time limitations, will accommodate as many such persons as possible.

It is anticipated that the oral hearings will also prove a useful adjunct to the rulemaking proceeding. Nevertheless, in order to facilitate the widest possible public participation, copies of all written submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data and arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974.

Proposed Rule 19b–3

The text of proposed Rule 19b–3 is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) Effective May 1, 1975, no national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires,

or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide effective May 1, 1975, in its rules of the exchange that nothing therein or in its practices shall be construed to require or permit its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(c) On and after May 1, 1975, no member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange.

If adopted, proposed Rule 19b–3 would by its terms become effective on May 1, 1975.

Proposed Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the NYSE, the provisions of Article XV of the NYSE Constitution could not be retained after May 1, 1975; the rule specifically covers intra-member rates as well as rates charged to non-members. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside of the normal pattern of exchange transactions. Proposed Rule 19b–3 covers any "rule of the exchange," which is defined to refer to any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges. Because of the long history of fixed commission rates, the Commission believes it would be appropriate, as provided by paragraph (b) of proposed Rule 19b–3, for exchanges to explicitly expunge the prior system by providing that nothing in their rules of the exchange or in their practices shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission.

The Commission anticipates that, if proposed Rule 19b–3 is adopted, the exchanges will proceed promptly to arrange for their rules of the exchange to conform, effective May 1, 1975, if not sooner, to the requirements of Rule 19b–3 in compliance with Section 6 of the Act. Nevertheless, in the event that all necessary exchange action is not completed prior to May 1, 1975, paragraph (c) of proposed Rule 19b–3 makes clear that no member of any exchange, or person associated with a member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange which paragraph (a) of proposed Rule 19b–3 would not permit an exchange to retain after May 1, 1975.

The rules of the exchanges have complex origins that will require careful examination in light of the adoption of Rule 19b–3. The Commission believes that exchanges should promptly undertake a comprehensive review of their rules in order to be in a position, if Rule 19b–3 is adopted, to undertake educational programs to acquaint their members with the provisions of any required new or revised rules as soon as possible.

Proposed Rule 10b–22

The text of proposed Rule 10b–22 is as follows:

Rule 10b–22. Prohibiting Fixing Rates of Commission by Brokers, Dealers or Members of Exchanges

(a) Except as provided in paragraphs (b) and (c) of this rule, it shall be unlawful for any broker, dealer or member of any national securities exchange ("exchange"), directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange as to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.

(b) Brokers, dealers and members of exchanges may participate in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8.

(c) The Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, may by order exempt from section (a) of this rule any agreement or arrangement, or agreements or arrangements, in respect of transactions in securities. The Commission may act either upon written request or upon its own motion and may impose upon any exemption such terms and conditions as it deems necessary or appropriate in the public interest or for the protection of investors.

Since proposed Rule 10b–22 would be intended to prevent any circumvention of the provisions of proposed Rule 19b–3, it would not be adopted if Rule 19b–3 were not adopted. If Rule 19b–3 is adopted,

Rule 10b–22 would not, if adopted, become effective prior to May 1, 1975.

Proposed Rule 10b–22 would prohibit brokers, dealers or members of national securities exchanges from participating, directly or indirectly, in any agreement or arrangement to fix any amount to be charged to other persons in respect of exchange transactions in securities. Since the prohibition is stated in terms of fixing of any "amount" to be charged to "other persons," it would make unlawful, for example, any agreement or arrangement with respect to either public commissions (that is, commissions charged to persons who are not members of an exchange) or intramember commissions (that is, commissions charged by members to other members).[7]

If plans currently in effect under Rule 10b–2 are appropriately amended to comply with the provisions of proposed Rule 19b–3 (and such amendments are declared effective pursuant to Rule 10b–2), proposed Rule 10b–22 would not prohibit any agreement or arrangement which is exempted from Rule 10b–2 by paragraph (d) thereof and by which any brokers, dealers or members of an exchange in effect agree on or arrange for an amount to be charged to their customers. Similarly, transactions permitted by Rules 10b–7 and 10b–8 would in all cases be excluded from the prohibition of proposed Rule 10b–22.

Because the Commission's responsibilities under the Act require that, among other things, it be sensitive to

[7] In addition to other remedies available to it, the Commission could, if proposed Rule 10b–22 is adopted, censure, deny registration to, suspend for a period not exceeding twelve months or revoke the registration of, any registered broker or dealer if the Commission determined that such broker or dealer, had willfully violated the provisions of proposed Rule 10b–22 and that such censure, denial, suspension or violation was in the public interest.

factors affecting the fairness, orderliness and efficiency of exchange markets, paragraph (c) of proposed Rule 10b–22 would permit the Commission to exempt certain agreements and arrangements. The Commission would only grant an exemption if, having due regard for the public interest and for the protection of investors, it concluded that the exemption would contribute to the maintenance of fair and honest markets. The Commission would welcome views on whether any specific exclusions from paragraph (a) of proposed Rule 10b–22 in addition, or as alternatives, to those set forth in paragraph (b) should be considered.

Source Materials

Set forth below is a list of some of the more important source materials relating to commission rate matters. While the list should not be assumed to be complete or exhaustive, it may prove useful to interested persons who wish to submit views, data and arguments with respect to the proposed rules.

Exchange Act Releases:

No. 8239 (Jan. 26, 1968) NYSE proposed rate structure changes.

No. 8324 (May 28, 1968) Order for institution of hearings on Commission rates.

No. 8399 (Sept. 4, 1968) Letter to NYSE regarding interim rate structure changes.

No. 8746 (Nov. 10, 1969) Letter regarding give-ups.

No. 8791 (Dec. 31, 1969) Issues covered in commission rate hearings.

No. 9007 (Oct. 22, 1970) Request to NYSE for new rate structure proposal.

No. 9079 (Feb. 11, 1971) Announcement of unfixing rates on orders in excess of $500,000.

No. 9096 (Mar. 4, 1971) Letter to NYSE regarding fixed intra-member rates.

No. 9105 (Mar. 11, 1971) Reaffirmance of competitive rates on orders in excess of $500,000.

No. 9132 (Apr. 1, 1971) Exchange of letters on commissions on institutional size orders.

No. 9148 (Apr. 14, 1971) Reaffirmance of $500,000 breakpoint.

No. 9950 (Jan. 16, 1973) Adoption of Rule 19b–2.

No. 10383 (Sept. 11, 1973) Policy conclusions with respect to, among other things, termination of fixed commission rates.

No. 10560 (Dec. 14, 1973) Letter to NYSE regarding commission rates generally.

No. 10670 (Mar. 7, 1974) Response to $2,000 breakpoint.

No. 10986 (Aug. 27, 1974) Procedural explanation of Commission approach to unfixing of commission rates.

No. 11019 (Sept. 19, 1974) Requesting rule changes to unfix commission rates.

Special Studies:

Wharton School of Finance and Commerce, *A Study of Mutual Funds,* H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

Securities and Exchange Commission, *Special Study of Securities Markets,* H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

Securities and Exchange Commission, *Institutional Investor Study Report,* H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

Studies and Reports Prepared or Commissioned by the New York Stock Exchange:

Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities and the Investing Public, New York Stock Exchange (Aug. 1968).

Reasonable Public Rates for Brokerage Commissions, National Economic Research Associates, Inc. (Feb. 1970).

Stock Brokerage Commissions, The Development and Application of Standards of Reasonableness for Public Rates, National Economic Research Associates, Inc. (Jul. 1970).

The Securities Markets, A Report, with Recommendations by William McChesney Martin, Jr. (1971).

Incentives to Exchange Membership in a Capital Market System, New York Stock Exchange (Nov. 1973).

Quarterly Analysis of Negotiated Rates, New York Stock Exchange (3rd qtr., 1971—2nd qtr., 1974).

Securities and Exchange Commission Hearings:

In the Matter of Commission Rate Structure of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–144 (1968–1971), consisting of 23 volumes of reported testimony and 15 volumes of written statements and exhibits.

In the Matter of the Structure, Operation and Regulation of the Securities Markets, Securities and Exchange Commission File No. 4–147 (1971), consisting of 24 volumes of reported testimony and 4 volumes of written statements and exhibits.

In the Matter of Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–167 (1973), consisting of 10 volumes of reported testimony and written statements and exhibits.

In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–171 (1974), consisting of 4 volumes of reported testimony and written statements and exhibits.

In the Matter of NASD Anti-Reciprocal Rule and Investment Company Brokerage Practices, Securities and Exchange Commission File No. 4–172 (1974), consisting of 3 volumes of reported testimony and written comments and exhibits.

In the Matter of Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–174 (1974), consisting of 4 volumes of reported testimony and written statements and exhibits.

Policy Statements:

Securities and Exchange Commission, *Report on the Public Policy Implications of Investment Company Growth,* H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966).

Securities and Exchange Commission, *Policy Statement on the Structure of a Central Market System* (Mar. 1973).

Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (Feb. 1972).

Congressional Hearings and Reports:

Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, S. Doc. No. 93–13, 93d Cong., 1st Sess. (1973).

Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs for the Period Ending Feb. 4, 1972, 92d Cong., 2d Sess. (1972).

Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. (1972).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126, 93d Cong., 2d Sess. (1974).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 470 and S. 488, 93d Cong., 1st Sess. (1973).

Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 5050 and H.R. 340, 93d Cong., 1st Sess. (1973).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3169, 92d Cong., 2d Sess. (1972).

Hearings on Securities Industry Study before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 1st Sess. (1972).

Hearings on Securities Industry Study before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 1st Sess. (1971).

Exchange Constitutions and Rules:

American Stock Exchange, Constitution and Rules, in particular, Constitution Art. VI, Rules 380–399.

Boston Stock Exchange, Constitution and Rules, in particular, Constitution Art. XVIII, Rules Ch. XVI.

Chicago Board Options Exchange, Constitution and Rules, in particular, Rules Ch. XIV.

Chicago Board of Trade, Rules and Regulations, in particular Rules Ch. VIII.

Cincinnati Stock Exchange, Rules and By-Laws, in particular, Rules Sec. 54, By-Laws Secs. 1, 2, 3, 4.

Detroit Stock Exchange, Constitution and Rules, in particular, Constitution Art. XVIII, Rules Ch. VII.

Intermountain Stock Exchange, Constitution and Rules, in particular, Rules Art. XVI.[8]

Midwest Stock Exchange, Constitution and Rules, in particular Rules Art. XXVIII.

[8] As indicated in n. 2, the Intermountain Stock Exchange will amend Art. XVI, effective May 1, 1975.

National Stock Exchange, By-Laws and Rules, in particular, Rules Art. 3–18.

New York Stock Exchange, Constitution and Rules, in particular, Constitution Art. XV, Rules 365–387.

Pacific Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIII, Rule IV.

PBW Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIX, Rules 671–698.

Spokane Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIX.

Miscellaneous Materials:

Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public,* 22 Stan. L. Rev. 675 (1970).

Demsetz, *The Cost of Transacting,* Quarterly Journal of Economics (Feb. 1968).

Friend and Blume, *The Consequences of Competitive Commissions on the NYSE* (1972). Reprinted in *Stock Exchange Commission Rates, Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs.* Also appears, in condensed form, in 28 Journal of Finance 795 (Sept. 1973).

Kahn, *The Economics of Regulation,* Vol. II, pp. 193–209. (1971).

Lorie, *Public Policy for American Capital Markets,* submitted to the Secretary and Deputy Secretary of the Treasury (Feb. 7, 1974).

Ratner, *Regulation of the Compensation of Securities Dealers,* 55 Cornell L. Rev. 348 (Fall, 1970).

All persons who wish to appear at the oral hearings should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1160, not

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later than November 8, 1974. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons. Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary no later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission

Washington, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934

Release No. 11093/November 8, 1974

FIXED COMMISSION RATES ON EXCHANGE TRANSACTIONS (FILE NO. 4–176)

On October 24, 1974, the Securities and Exchange Commission released for public comment proposed Securities Exchange Act Rules 19b–3 and 10b–22.[1] The Commission also announced that it would hold oral hearings, beginning on November 19, 1974, to obtain oral presentations of views, data and arguments and published a list of source materials to which interested persons could refer in submitting comments on the proposed rules. In addition, the Commission is today releasing the following staff synopsis relating to fixed commission rates on exchange transactions.

[1] Securities Exchange Act Release No. 11073, 39 Fed. Reg. 38396 (Oct. 31, 1974). Proposed Rule 19b–3 would, among other things, prohibit national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge any person any fixed rate of commission for transactions executed on, or effected by use of any facility of, such exchanges. Proposed Rule 10b–22 would, among other things, make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.

Introduction

From the enactment of the Securities Exchange Act in 1934 until 1968, rates of commission for transactions on exchanges were adjusted at infrequent intervals; for example, the commission rates of the New York Stock Exchange (the "NYSE") had been adjusted five times, or roughly once every seven years.[2] Beginning, however, with the *Wharton Report*[3] in 1962 and the *Special Study* in 1963, the exchange commission rates became the subject of intensive study, and, since 1968, the exchanges have made numerous changes in their commission rates, often in response to requests from the Commission. Since 1958, the NYSE's commission rates and related proposals have generally been followed by other exchanges and, accordingly, the following discusssion often refers to the NYSE's proposals and the Commission's reactions to them.

Commission Action Relating to Fixed Commission Rates

In January, 1968, the NYSE, in response to Commission concern with respect to the operation of the commission rate schedules then in effect, submitted to the Commission a proposal for certain revisions in the structure of its commission rate schedule. The proposal provided for volume discounts, economic access to the NYSE for non-member broker-dealers through a professional discount, limited recognition of "customer-directed give-ups"[4] and prohibitions on

[2] Securities and Exchange Commission, *Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) (hereinafter referred to as the *Special Study*), pt. 2 at 329–333.

[3] Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

[4] The customer-directed give-up was a payment by the executing broker of a part of the minimum commission it was required to charge its customer to other broker-dealers designated by the customer or his investment adviser. The amount of the payment was negotiated.

procedures then used by institutions to recapture commissions. The Commission's release with respect to that proposal described in some detail the commission rate schedule then in effect.[5] The release also described in some detail the give-up and reciprocal business practices which had been adopted in order to evade the fixed commission structure.[6]

[5] Securities Exchange Act Release No. 8239 (Jan. 26, 1968). The schedule then in effect prescribed a minimum commission rate, based on the value of the 100-share round lot, for each transaction regardless of size—the commission on an order for 10,000 shares was required to be 100 times the commission on an order for 100 shares. The *Institutional Investor Study Report* of the Securities and Exchange Commission, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971) (hereinafter referred to as the *Institutional Investor Study Report*), later accepted the conclusions of the July NERA Report prepared for the NYSE (see n. 13, *infra*) with respect to costs of executing transactions. It stated that "the average cost of handling a 1,000 share, a 10,000 share and a 100,000 share order of a $40 stock in 1969 was respectively, about 6, 42 and 377 times as great as the average cost of handling a 100 share order, yet the commission charged in 1968, was respectively, 10, 100 and 1,000 times the 100 share commission [footnote omitted]." *Institutional Investor Study Report*, vol. 4, at 2172.

[6] Normally, the customer's investment adviser directed give-ups to those brokers who had rendered it various services. The give-up was, thus, a means of utilizing the commission dollars paid by redirecting them to others in return for services often unrelated to the transaction that generated the commission. *See Special Study*, pt. 2 at 316; Securities Exchange Act Release No. 8239 (Jan. 26, 1968), 33 Fed. Reg. 2393 (Jan. 30, 1968). The *Institutional Investor Study Report* concluded in vol. 4, at 2199:

"The prevalence of the give-up demonstrated that NYSE firms specializing in execution and clearance for institutions were willing to perform this function for significantly less than

After receiving comments, the Commission instituted a public investigatory hearing to consider whether changes should be made in the rules, policies, practices and procedures of exchanges repecting commission rate structure since it appeared that the commission rate structure then in effect did not, in fact, provide fixed minimum commission charges on many exchange transactions. As an interim measure, the Commission requested adoption of a revised commission rate schedule which, among other things, prescribed reduced rates for that portion of an order involving round lots in excess of 400 shares or, alternatively, the elimination of requirements for minimum rates of commission on all orders in excess of $50,000.[7]

In the midst of the hearings the NYSE stated that it would adopt an interim commission rate schedule providing for volume discounts and that it would retain economic consultants to develop a cost-based commission rate schedule. In December, 1968, the NYSE and other exchanges adopted, as an interim commission rate schedule, a volume discount on orders over 1,000 shares and at the same time banned customer-directed give-ups, which the Commission had indicated were inconsistent with a premise that a fixed minimum commission schedule was necessary and appropriate to the effective and efficient operation of an exchange.[8]

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the commission imposed by the NYSE commission schedule and that other NYSE members not participating in the execution and clearance of portfolio orders were receiving commission dollars at the direction of the institution for services unrelated to the portfolio transactions, perhaps for example, for the sale of investment company shares."

[7] Securities Exchange Act Release No. 8324 (May 28, 1968).

[8] Securities Exchange Act Releases Nos. 8382 (Aug. 9, 1968) and 8399 (Sept. 4, 1968).

The economic study commissioned by the NYSE was scheduled to be based on data for the year 1969 and to be completed by June, 1970, and the Commission agreed to await completion of that study before resolving the basic question of whether rate-fixing by exchanges should be replaced by competition.[9]

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[9] Nevertheless, certain of the issues under consideration were recognized as having been sufficiently identified and explored at the hearings to allow the Commission to invite written submissions and to hear oral presentations in preparation for the resolution of those issues, in whole or in part. Therefore, a list of questions was published in order to give specific direction to views and comments on those issues. Securities Exchange Act Release No. 8791 (Dec. 31, 1969). In response to that invitation the Antitrust Division of the Department of Justice stated that, on the basis of its review of the hearings and study of the problem, it believed that a sound and reasonable method of transition could be and should be developed:

"A transition program would permit the Commission to institute competitive commissions gradually. It would be appropriate to begin with that part of securities trading in which effective and workable competition has already been evidenced, and where fixed rates have led to serious difficulties—i.e., the larger-volume transactions. The Commission could thus order the elimination of fixed rates on all transactions over a certain size and gradually reduce the specified size until all minimum rates had been eliminated. A gradual transition would also permit firms to adjust to the competitive system and would provide the Commission with an opportunity to take regulatory measures * * * to deal with any problems which may emerge.

"Accordingly, we recommend that the Commission should proceed to formulate a program of transition to competitive commissions, and to take appropriate action to put the program into effect under the Exchange Act, including Section 19(b)."

Memorandum of the United States Department of Justice on the Fixed Minimum Commission Rate Structure, January 17, 1969, at 194–195. *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

The preparation of the NYSE-commissioned study was subsequently accelerated; on February 12, 1970, the NYSE announced that its Board of Governors had reviewed a proposed new rate schedule approved by its Cost and Revenues Committee and authorized its presentation to the Commission. The NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (the "February NERA Report"). The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the February NERA Report and that the February NERA Report was merely a study presented for discussion.[10]

In March, 1970, the NYSE proposed the imposition of an emergency 90-day surcharge on orders of 1,000 shares or less, to which the Commission did not raise any objection.[11] When the NYSE proposed to continue the surcharge for an additional 90 days, the Commission held public hearings on the proposal and determined not to raise any objection if the surcharge should be continued until such time as circumstances warranted its termination.[12]

The Commission thereafter reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the February NERA Report, by limiting

[10] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[11] Securities Exchange Act Release No. 8860 (Apr. 2, 1970).

[12] Securities Exchange Act Releases Nos. 8923 (July 2, 1970) and 8969 (Aug. 31, 1970).

increases on small orders and decreases on large orders called for in the original study.[13]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates. At the same time the Commission stated that it was of the opinion that fixed charges for portions of orders in excess of $100,000 seemed neither necessary nor appropriate and it further requested that a plan for reasonable economic access for nonmember broker-dealers be presented.[14]

[13] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, A Report by National Economic Research Associates, Inc. to the Cost and Revenues Committee of the New York Stock Exchange" (Jul. 1970) (the "July NERA Report"). The February NERA Report had proposed a 116.3 percent increase in the commission on an order involving 100 shares of a stock selling at $10 per share. The NYSE proposal in July called for a 50 percent commission increase for that order. For an order of 1,000 shares of a stock selling at $50 per share, the February NERA Report had proposed a 36.3 percent commission rate reduction. The July NYSE proposal called for a 10 percent commission increase for that order. For further comparisons, see Table XI–4 of the February NERA Report and Tables XI–3 and XII–3 of the July NERA Report.

[14] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). Nevertheless, by the end of 1970 it appeared that the banning in 1968 of customer-directed give-ups and the simultaneous in-

By March, 1971, when the Commission transmitted the *Institutional Investor Study Report* to the Congress, it had concluded:

> The fixed minimum stock exchange commission on large orders has led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interest, to be anticompetitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems.[15]

Nothing that has occurred since the submission of the *Institutional Investor Study Report* suggests any need to withdraw its perception of the regulatory problems of the fixed commission rate structure.

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology

troduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See*, Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also Institutional Investor Study Report*, vol. 4, at 2206.

[15] *Institutional Investor Study Report*, vol. 1, at xxii.

developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for nonmember brokers at a discount of up to 40 percent from the public rate).[16]

Beginning in October, 1971, the Commission held hearings on the structure of the securities markets and, on February 2, 1972, issued its *Statement on the Future Structure of the Securities Markets* (the "*Market Structure Statement*"), which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[17] The *Market Structure Statement* concluded that a reduction to $300,000 was indicated in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed com-

[16] The Commission also indicated that the inability appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms and that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Releases Nos. 9148 (Apr. 14, 1971) and 9351 (Sept. 24, 1971).

[17] The *Market Structure Statement* expressed the unanimous view of the then Commission (Chairman Casey and Commissioners Owens, Needham, Herlong and Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

mission rates for a very long time and that it would therefore be appropriate to measure the effect of competitively determined commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement towards competitive rates, but concluded that that did not rule out moving towards competitive rates, at least on large orders, at a measured, deliberate pace.[18] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

Congressional Conclusions With Respect to Fixed Commission Rates

At the same time that exchanges, in response to requests from the Commission, began introducing competitively determined commission rates on large transactions, the Congress was studying the operation of the securities industry and securities markets of the United States. After reviewing arguments that the abolition of minimum commissions entailed greater risks than are necessary to achieve the objectives of a

[18] *Market Structure Statement* at 16. At about the same time, the *Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce* concluded, after looking at the business practices of the brokerage industry that had arisen over the preceding several years in response to the abolition of the customer-directed give-up: "Institutions and the brokerage community were able to split commissions by devices which achieved the same results as 'give-ups,' such as the 'four-way ticket'; the 'eight-way ticket'; the 'step-out'; the 'mirror transaction,' and other similar schemes which have been aptly described as 'Byzantine.'" *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, H.R. Doc. No. 92–1519, 92nd Cong., 2d Sess., at 133 (1972) (hereinafter referred to as the *House Study*).

fair and economic level and structure of commission rates, an interim report issued by the Senate Subcommittee on Securities reached the same conclusions that the Commission had earlier reached. That report stated:

> While it is concededly impossible to predict the precise consequences of eliminating the fixed minimum commission rate system, it is equally impossible to predict the precise consequences of maintaining that system. There are risks in standing still as well as in moving forward. The experience of the securities industry over the past several years is hardly such as to inspire confidence in the adequacy of the present system. * * * To the extent that fixed commission rates failed to prevent, or even aggravated, these conditions, the relative "risks" of moving toward a new system are correspondingly lessened.
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> * * * * *
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> On the basis of a review of these developments and the opposing arguments as to the relative merits of fixed and competitive rates, it is clear that the interests of the investing public, as well as the long-term health of the securities industry itself, require that stock exchange members be free to set their own commissions on transactions effected for their customers, subject to whatever anti-discrimination rules or other protections the SEC may deem appropriate.
>
> This does not, of course, mean that the fixing of rates should be eliminated in one step. Even the sharpest critics of the fixed rate system have recognized the need to permit the industry to adjust to rate competition in an orderly manner over a period of years. However, in order to begin making that adjustment, the industry needs, and is entitled to, a clear statement of

government policy that fully competitive rates are the goal toward which we are moving.[19]

The Report of the Senate Committee on Banking, Housing and Urban Affairs on S. 470 subsequently stated that the issues of institutional membership and fixed commission rates, while to some exent analytically distinct, were, as a practical mater, inseparable:[20]

> [A]lthough the committee believes that fully competitive rates are necessary and approprate for the long-term health of the securities industry, the development of a true central market system, and the protection and fair treatment of investors, there are serious difficulties vith any attempt by the Congress to set the preise date on which fixed rates are to be eliminatd.[21]

The Senate Committee decided, therefore, not to remove from the Commission its power to reguate

[19] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs* (For the Period Ended February 4, 1972), 92nd Cong., 2d Sess., at 57–60 (1972). *Cf.*, Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973), which provided that clear statement.

[20] The Commission was similarly persuaded that the isues were, in some respects, related but nevertheless determined that it was appropriate to take initial action on the matter of proper utilization of exchange memberships. It ultimately adopted Rule 19b–2 under the Act (Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973)) without, foreclosing the possibility that further changes migh be necessary or appropriate.

[21] *Regulation of Securities Trading by Members of National Securities Exchanges and the Sale of Investment Advisers of Registered Investment Companies, A Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 470*, Sen. Doc. No. 93–187, 93d Cong., 1st Sess., at 3 (1973).

exchange practices and set the pace for evolutionary changes, subject, of course, to any judicial review as might be appropriate. It noted that:

> So long as commission rates remain fixed and institutions, and all other investors, are unable to obtain brokerage services at prices which the forces of competition have determined to be reasonable, there will inevitably be efforts to circumvent the effect of fixed rates. These efforts have resulted and undoubtedly will continue to result in the creation of complex reciprocal practices which cause inefficient allocations of economic resources, exacerbate conflicts of interest, foster anticompetitive business practices and impede the development of a central market system for securities trading.[22]

The House Subcommittee on Commerce and Finance reached the same basic conclusions:

> The fixed commission rate system has led to heightened conflicts-of-interest and distortions in trading patterns. The economic incentive for these patterns should disappear with the implementation of a competitive rate system. [Footnote omitted.] Such a system will also allow investors to purchase only those brokerage services they desire and at prices which are reasonably related to cost. [Footnote omitted.]
>
> Other benefits will also accrue under a competitive system. Fixed minimum rates have tended to focus brokerage house executives' efforts on building sales, with little or no regard for costs. A competitive rate system will change this focus and will, we believe, benefit both the industry and its customers.
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> * * * * *
>
> It is also clear from the record that the central market system, which appears to have the unqualified support of all segments of the securi-

[22] *Id.*

> ties industry and those who regulate it, can never be accomplished in an environment of fixed rates. * * * [T]he abolition of fixed minimum rates will facilitate the speedy development of a central market system.[23]

The House Subcommittee also recognized that there was general agreement that the securities industry had lived its whole life (insofar as exchange agency business was concerned) in a world of fixed prices and needed time to adjust to the world of competition and that a balance must be struck between the need of the industry to adjust and the rights of investors.[24]

The Commission's Policy Conclusion

In May, 1973, the NYSE proposed to increase rates by 15 percent on orders from $5,000 up to $300,000 and by 10 percent on orders involving from $100 to $5,000, and to remove the then existing prohibition, which had originated in 1970, on charging small investors more than the minimum commission. The Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed increases or to their continuation through March 31, 1974.[25] The Commission further determined that it would not

[23] *House Study* at 141–142.

[24] *House Study* at 143.

[25] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). On the preceding March 1, however, the NYSE Board of Directors had adopted a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on registered national securities exchanges operating under similar rules and regulations. NYSE *Policy Statement*, March 1, 1973.

On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974).

raise any objection if those increased rates should be continued by the exchanges from April 1, 1974, to April 30, 1975, if rules were adopted (i) eliminating prohibitions on member firms' charging, on small orders, commission rates exceeding the minimum commission and (ii) permitting, but not requiring, member firms to compete to a limited extent on the basis of the price of brokerage services. The Commission also indicated that it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as later modified by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, the NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitively determined commission rates. The Commission then held a public hearing with respect to intra-member rates. In its opening statement at the hearings, the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[26]

[26] Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

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The Commission's Request and Subsequent Rule Proposal

Following a preliminary announcement on August 27, 1974,[27] of its plan to initiate steps concerning the alteration of the existing rules and practices of national securities exchanges requiring members to charge fixed rates of commission on securities transactions effected on exchanges, the Commission on September 19, 1974, made a formal request that national securities exchanges effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that required, or had the effect of requiring, exchange members to charge any person any fixed rate of commission.[28] One national securities exchange has indicated that it would comply with the Commission's request; seven national securities exchanges have indicated that they would not comply voluntarily with the Commission's request.[29]

[27] Securities Exchange Act Release No. 10986.

[28] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974). In addition, the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates.

[29] The Intermountain Stock Exchange has indicated that it would comply with the Commission's request. The American, Boston, Chicago Board Options, Cincinnati, Detroit, Midwest and New York Stock Exchanges have indicated that they would not comply.

The American Stock Exchange (the "Amex") has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates

Accordingly, in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31,

and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The Chicago Board Options Exchange (the "CBOE") has indicated that it will continue its policy of conforming its rate structure basically to whatever may be the rate structure from time to time elsewhere. In accordance with that policy, the CBOE would have expected to file rule changes complying with the Commission's request if the other major exchanges had done so on or before November 1, 1974; but, since the other major exchanges have not done so, the CBOE will either submit its arguments or simply await the outcome of the Commission's proceedings. The CBOE believes that, with respect to its Board Brokers (who differ from the specialists on other exchanges in that Board Brokers do not have a dealer function), the proper solution is to require that each Board Broker post his rates and that such rates be uniform and non-discriminatory among customers. The CBOE will request an exception to Rule 19b–3 if and when other floor rates are required to be negotiated.

The Cincinnati Stock Exchange (the "CSE") has stated that it is of the opinion that to adopt rules permitting fully negotiated commission rates would not be in the public interest because to do so would only favor the large institutional investor and thus place a burden on individual customers, who are said to generate the most business for the majority of the CSE member firms. The CSE is also of the opinion that negotiated commissions would not be in its member firms' interest since many smaller firms could simply not compete with larger organizations; the inability to compete does not necessarily mean an inefficiently run operation, but rather that a small business is unable to face the stiff competition of big business. The CSE is, finally, of the opinion that negotiated commission rates would not be in its interest since, with the elimination of many of its member firms and the institutionalization of the market, the CSE would cease to exist. In July, 1974, the CSE did, however, eliminate fixed intra-member rates. The CSE believes that the demise of the auction market would be a great disservice to the general investing public.

1974), the Commission published proposed Rules 19b–3 and 10b–22 and scheduled oral hearings, commencing

The Detroit Stock Exchange has reviewed the results of an advisory vote of its membership and took no action with respect to amending its constitution to eliminate the fixed commission structure.

The Midwest Stock Exchange, Incorporated (the "MSE"), has reaffirmed its position, first announced in June, 1973, favoring elimination of fixed public rates. In so doing, the MSE stated that it recognized that public policy calls for the early ending of fixed public rates. At the same time, it stated, in light of a number of unfavorable circumstances or unresolved problems, the MSE believes that there is need for caution as to the effective date of the transition and hopes that the Commission will explore the present areas of concern and prospects for alleviating them before finally settling on a May 1, 1975, effective date. The MSE observed also that its June, 1973, position that a competitive rate environment is preferable to a regulated rate environment from all viewpoints is predicated on meeting concerns that (1) exchange membership for the purpose of handling affiliated business should not be permitted; (2) nation-wide clearance and depository facilities on an interfaced basis should be in existence so as to strengthen the industry operationally; and (3) there should be appropriate restructuring of operating and regulatory methods to fit the new environment in which exchange membership will no longer be defined in terms of preferred rate treatment. The MSE also indicated that it believes there may be new problems bearing on the appropriate effective date for complete termination of fixed public rates, including (1) fiduciary principles with respect to commissions and (2) a greatly deteriorated national and world economic situation, including monetary stress, oil and food situations and extremely high rates of inflation and money costs, all of which continue, it stated, to have serious direct impacts on the securities industry. The MSE noted further that it hoped that the hearings will provide an opportunity not only to explain further its belief that those concerns and problems should be taken into account in fixing an effective date for the transition to competitive public rates, but also to explore possibilities for their early resolution. In the case of floor rates, the MSE stated its belief that there should be further opportunity to explore not only the question of timing but also the substantive change itself, and it requested an opportunity to present its views on both questions at the oral hearings.

The NYSE has indicated it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has therefore indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which, among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. The NYSE has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

on November 19, 1974, as an adjunct to the rule-making proceeding.

Collateral Considerations

The foregoing background information is only a brief summary of more than a decade of Commission and Congressional study and Commission action with respect to fixed rates of commissions on exchange transactions. Not included is any review of related questions, such as the financial conditions of the brokerage industry and preservation of its ability to provide professional investment services in the context of changes in commission rate practices of long standing, the growth in institutional trading on exchange markets and the back-office crisis in the brokerage community in 1969 and 1970 and its aftermath.

Before institutional trading on exchanges had become significant, anomalies of commission rate sched-

ules did not create such acute regulatory problems. Rapid changes, however, occurred during the 1960's in patterns of exchange trading, and there was an increase in phenomena associated with institutional reaction to the fixed commission rate structure.[30] As, however, the Commission was preparing to reach conclusions on some aspects of rate matters in 1970, the brokerage industry began to encounter substantial difficulties. Those difficulties were the consequence of turmoil caused in large part by very active trading and the absence of a corresponding recognition on the part of the securities industry of the need to increase trained and experienced back-office employees or to develop operating procedures adequate for the expanded volume.[31]

In the particular settings before the Commission, it had the responsibility to determine the pace at which changes in fixed commission rate schedules should be introduced, to proceed cautiously, tempering long-term solutions in light of possibly dangerous short-term consequences, and to avoid undue risks to

[30] In 1961, institutional trading accounted for 38 percent of public volume, based on value, on the NYSE; in 1971, it accounted for 68 percent. NYSE, *1974 Fact Book* 55 (1974). The NYSE has testified that the trend was continuing. *Hearings Before the Subcommittee on Financial Markets of the Senate Committee on Finance*, 93d Cong., 1st Sess., pt. 1, at 104–105 (1973).

[31] *See* Securities Exchange Act Release No. 8791 (Dec. 31, 1969), in which the Commission solicited views and comments concerning the fixing of commission rates. For a description of the financial and operational crisis that afflicted the brokerage community in the late 1960's, see *Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs*, S. Doc. No. 93–13 93d Cong., 1st Sess. 28–29 (1973).

investor protection and the public interest.[32] Indeed, even under fixed minimum commission rates established by the exchanges, the brokerage industry has experienced substantial structural realignments.[33]

[32] Balancing competitive principles against other desirable ends cannot be done outside a regulated environment—the Supreme Court has specifically noted, "it is not for the courts to determine whether in particular settings price-fixing serves an honorable or worthy end." *United States* v. *National Ass'n of Real Estate Boards*, 339 U.S. 435, 489 (1950). For a definitive discussion of the Commission's authority under Section 19(b) of the Act, *see* Securities Exchange Act Release No. 9950, "Adoption of Rule 19b–2 under the Securities Exchange Act of 1934 Governing Utilization of Exchange Membership for Public Purposes" (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973). *See also PBW Stock Exchange* v. *Securities and Exchange Commission*, 485 F. 2d 718 (3d Cir. 1973), *cert. denied*, 40 L. Ed. 2d 558 (1974). In discussing the Commission's action with respect to commission's rate review, including the policy conclusion of September 11, 1973, to terminate the fixing of commission rates, the Second Circuit recognized that measured withdrawal of the fixed commission rate structure could avoid the loss of investor funds. *Gordon* v. *NYSE*, 498 F. 2d 1303 (2d Cir.), *petition for cert. filed*, 43 U.S.L.W. 3148 (U.S. Sept. 19, 1974) (No. 74–304).

[33] A general trend toward fewer NYSE member organizations has been apparent for more than a decade. In 1961 there were 681 NYSE member organizations; that number has declined in each subsequent year but one and stood at 523 at the end of 1973. On the other hand, at the end of 1973, the number of offices operated by NYSE members remained above the corresponding number in 1961, as did the number of registered representatives. *See* NYSE, *1974 Fact Book*, 84 (1974). The NYSE has suggested that there has been a further decline in number of member firms (to 512) and branch offices (a decline of approximately six percent) during the first nine months of 1974. *In the Matter of Commission Rate Schedules of Registered National Securities Exchanges*, NYSE Exhibit 7, Securities and Exchange Commission File No. 4–174 (1974). At the end of the 1960's, there was a serious shift in the general trend towards fewer member organizations. Several major

Developments since 1970, such as implementation of the Securities Investor Protection Act of 1970,[34] revision of financial responsibility rules,[35] implementation of new rules with respect to custody of customer funds and securities [36] and improved surveillance procedures [37] have made it possible for the Commission to require changes in commission rate practices without unnecessary risk to investor protection or the public interest. As noted above, the Commission has required the introduction of competitively determined commission rates on both large and small transactions. The brokerage community has thus had an opportunity to develop methods of doing business in the new environment, and there has been an opportunity for the establishment of reasonable commission rates through the interaction of competitive forces.

brokerage firms collapsed, exhausting the trust funds established by the exchanges to protect customers of member firms. Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Broker-Dealers*, H.R. Doc. No. 92-231, 92d Cong., 1st Sess. 16 (1971).

[34] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Of that 94, six liquidations had been completed and in 78 others substantially all customer claims had been satisfied. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974). *See also The Wall Street Journal*, Nov. 7, 1974, at 4, col. 1.

[35] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[36] Rule 15c3-3 under the Securities Exchange Act of 1934, 17 CFR 240.15c3-3.

[37] *See*, Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16-17 (1974).

The Current Perception of Fixed Commission Rates under the Act

The history of fixed commission rates for exchange-executed transactions, of course, dates back to the Buttonwood Tree agreement in 1792. Fixed minimum rates have thus had a long history. This synopsis is not intended to indicate, and, indeed, there is no need to indicate, that the maintenance of a fixed rate system for exchange transactions has always been inappropriate.[38] Nevertheless, the foregoing review of the operation of the fixed minimum commission rate structure since the 1960's, particularly in light of the dramatic increase in trading by institutional investors, has demonstrated that the fixed rate structure, both in the 1960's and as subsequently modified, was unsuited to the new demands upon the exchange markets, particularly the influx of institutional orders.

This synopsis relating to fixed commission rates on exchange transactions is, of course, not the appropriate vehicle for coming to final determinations with respect to the reasons why proposed Securities Exchange Act Rules 19b-3 and 10b-22 should be adopted.[39] Nevertheless, based upon the data available at present, and subject to any further information,

[38] Indeed, in 1934, the Congress itself, in drafting the Act, recognized that fixed commission rates might be necessary or appropriate under particular circumstances and delegated to the Commission pervasive authority not only to eliminate a fixed rate system but, alternatively, to regulate a system of fixed rates on exchanges so long as it appeared to the Commission to be necessary or appropriate to do so.

[39] The hearings scheduled to commence on November 19, 1974, complemented by the prior hearings and studies discussed above and the other materials listed in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974), will assist the Commission in determining whether to adopt those rules or take some other appropriate action.

data and views which may be adduced at the hearings on proposed Rules 19b–3 and 10b–22, it should be noted that the Commission's constant review and analysis of the market structure and functioning, particularly since the 1960's, has contributed to a conclusion by both the Commission and knowledgeable committees and subcommittees of the Congress that the fixed rate system, even as modified over the last decade, has heightened conflicts of interest and distorted trading patterns, has seriously disadvantaged various classes of public investors and has tended to work against the development of a meaningful central market system for listed securities.[40]

Furthermore, there do not appear to be countervailing considerations which might relate to the public interest or the protection of investors that appear sufficiently significant to stay the Commission from the proposed implementation of its policy conclusion.[41]

[40] *See* pp. 2–23, *supra*.

[41] For example, *see* the *House Study*, which concurred "with the [then] president of the New York Stock Exchange that 'the fixed minimum commission rate * * * has itself been the greatest fragmenter of the market' [footnote omitted] and with his view that with fully negotiated rates business will be done on the basis of depth, liquidity, and continuity of the marketplace * * *.'" [footnote omitted] *House Study* at 138. *See also Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 2519*, 93d Cong., 1st Sess. (1973), at 189, 191, 477; *Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126*, 93d Cong., 2d Sess., at 171–178 (1974).

Similar statements have been made by other industry representatives, although they have, on other occasions, modified or even retracted their prior pronouncements. *See, e.g., Hearings Before the House of Representatives Committee on Interstate and Foreign Commerce on H.R. 5050 and H.R. 340*, 93d Cong., 1st Sess. (1973), at 997; *Hearings Before the Subcommittee on*

It should be recognized that consideration could be given to whether or not an appropriate fixed rate structure should be constructed as part of a regulatory program of a type commonly employed by governmental entities that regulate utilities.

Such a program, if developed, would appear to have undesirable collateral consequences to the extent it entails a loss of freedom on the part of exchange member firms to exercise their independent judgment in seeking the business of, and furnishing services to, customers of their own choosing. Member firms have not shown any general inclination to support that kind of program, and it must be recognized that such a program would seem to call for elaborate new regulatory structures which might be inconsistent with current public policy views and introduce costs and economic inefficiencies which would have to be carefully balanced against the degree to which the regulatory purposes of the Act could thereby be furthered.[42]

More generally, the *House Study* concluded that, since price fixing is not the norm in a society of free competitive enterprise, "[t]hose who would maintain the fixed minimum commission system bear the burden of proving that it is in the public interest."[43] At the same time, the House Study noted:

Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126, 93d Cong., 2d Sess., at 78 *et seq.*, 155–156, 161 and 178–180 (1974).

[42] In that connection, it should be noted that the exchanges have not made progress in developing a rational methodology which they would be willing to support and which could, in the Commission's judgment, be used to measure the reasonableness of such schedules in the future.

[43] *House Study* at 141. *See also* Securities and Exchange Commission File No. 4–171, Transcript at 45 (1974).

It is often said that while most industries study problems to death, the securities industry studies solutions to death. During the past decade there have been four major studies of the securities industry conducted under the auspices of the SEC. Additionally, the SEC has conducted two major administrative proceedings focusing on the commission rate question and its impact on the structure of the securities industry. These matters have also received the attention of this Subcommittee and the Senate Securities Subcommittee in the current studies of the securities industry. In all, in the past decade there have been at least eight major studies dealing in whole or in part with commission rates and their effect on the industry. The time for study has ended. The time for action has arrived."

Under present circumstances, therefore, it no longer appears necessary or appropriate, in furtherance of any of the purposes of the Act, to permit national securities exchanges to continue to fix the commission rates their members must charge. That conclusion is not retrospective and is, of course, not inconsistent with the fact that such a system in the past may have been justified or may have served valid regulatory purposes. In all events, justifications once adequate may cease to be so and, consequently, a regulatory agency's quasi-legislative action must be predicated on current needs and trends."[45] Similarly, continued monitoring of,

[44] *House Study* at 141. Nevertheless, since the *House Study*, the Commission has held four series of hearings in addition to those to be held in connection with proposed Rule 19b–3 and 10b–22. Securities and Exchange Commission File Nos. 4–167 (1973), 4–171 (1974), 4–172 (1974) and 4–174 (1974).

[45] Since, as noted at p. 34 and n. 46, *infra*, shifting trends can require modification of regulations which previously seemed necessary or appropriate, the regulatory agency in which the Congress has vested the responsibility for administering the

and possible structural changes in, the securities markets over the coming years conceivably could suggest that, under new circumstances and with further experience with the issues, reasonable men might tend toward different conclusions based upon the purposes and standards of the Act."

* * * * *

relevant statutory provisions must exercise a continuing oversight.

Current needs and trends not only are the predicate for requiring that old rules and practices be abandoned; they also require the agency to ensure that new policies are not circumvented. Thus, the Commission has proposed Rule 10b–22 to be adopted if proposed Rule 19b–3 is adopted. At the same time, implementation of a new regulatory environment, even after years of preparation and experimentation, may require some flexibility. On that basis, the administrative process should explore particular ramifications of the new policy carefully and under controlled circumstances, in terms of the relevant statutory principles. Subsection (c) of proposed Rule 10b–22 is an effort to provide an appropriate method by which the Commission can fulfill that important function.

"As the Commission previously has noted, in an analogous context—the adoption of Securities Exchange Act Rule 19b–2:

"The action taken * * * in adopting Rule 19b–2 is not intended to and could not, in light of shifting currents and patterns in the structure of the nation's securities markets, be a definitive resolution of the problems facing the securities industry in this area. * * *

* * * * *

"We have not, in adopting Rule 19b–2, foreclosed the possibility that further changes may, after experience with the rule is gained and after the emerging structure of a central market system is more sharply delineated, be necessary or appropriate. * * * In an area of activity as dynamic and complex as this, there may not be any permanent resolution of industry problems; as conditions change, existing problems may be superseded by new problems, and existing "solutions" may be rendered obsolete. The effective utilization of administrative responsibility and pervasive regulatory oversight de-

As previously indicated, all persons who wish to appear at the oral hearings, which commence on November 19, 1974, should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C., 20549, telephone number (202) 755–1160. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons.

Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary not later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

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mands that the agency charged with oversight of an entire industry, such as the Commission, [footnote omitted] remain alert to these changing patterns and problems. We intend to do just that."

Securities Exchange Act Release No. 9950 (Jan. 16, 1973) at pp. 2–3, 38 Fed. Reg. 3902 (Feb. 8, 1973).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11203/January 23, 1975

ADOPTION OF SECURITIES EXCHANGE ACT RULE 19B–3

The Securities and Exchange Commission, acting pursuant to the authority vested in it by the Securities Exchange Act of 1934,[1] and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[2] has adopted Rule 19b–3. The rule will be effective as to the rates charged by members of national securities exchanges (exchanges) on transactions for persons other than members or associated members (public rates), and for clearance charges,[3] on May 1, 1975, the date originally proposed. As to floor brokerage rates, that is, rates charged to members or associated members except for clearance, the effective date will be May 1, 1976. The rule has otherwise been adopted substantially in the form pro-

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[1] 15 U.S.C. 78a *et seq.* (hereinafter cited as the Act).

[2] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

[3] In its statement of May 29, 1974, at the *Intra-Member Rate Hearings*, the New York Stock Exchange concluded that fixed rates for clearance could be determined on a competitive basis at the same time as public rates were so determined. Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

posed.[4] The Commission has determined not to adopt proposed Rule 10b–22.

The Commission's determination to defer the effective date of the rule as to floor brokerage rates is based essentially on the following considerations. In the first place, the Commission recognizes that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to the new environment. In addition, it appears that many exchange members did not fully appreciate until September, 1974, following intra-member rate hearings, that the Commission's policy conclusions with respect to fixed commissions, which were announced on September 11, 1973, were applicable to floor brokerage rates and that, consequently, such members may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide. Finally, floor brokerage rates have considerably less impact on public investors than do public rates.[5]

The Commission's decision not to adopt Rule 10b–22 is based, in part, upon a consensus which developed at the *19b–3 Hearings*.[6]

[4] Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974).

[5] Nothing in Rule 19b–3, however, requires exchanges to wait until May 1, 1976, to eliminate fixed floor brokerage rates, or for that matter, to wait until May 1, 1975, to eliminate fixed public rates.

[6] *In the Matter of Proposal to Adopt Rules 19b–3 and 10b–22 Concerning the Fixing of Commission Rates by National Securities Exchanges*, Securities and Exchange Commission File No. 4–176 (1974).

Rule 19b–3 essentially prohibits any exchange from adopting or retaining any rule that requires, or from otherwise requiring, its members to charge fixed rates of commission for transactions executed on or by the use of the facilities of such exchange after the applicable effective dates. Rule 19b–3 further requires each exchange after the applicable effective dates to provide in its rules that nothing therein shall be construed to require or authorize members to agree or arrange for the charging of fixed rates of commission. The rule would also relieve exchange members and their associated persons of any obligation to comply with rules prohibited by its basic provision, regardless of whether or not the exchange has amended such rules, and such rules could no longer be relied upon. This latter provision, among other things, provides for the contingency that some exchange may not have completed the necessary process of rule amendment by the applicable effective dates of the rule.

Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the New York Stock Exchange (NYSE), the provisions of Article XV of the NYSE Constitution relating to floor brokerage could be retained after May 1, 1975; but such provisions may not be retained after May 1, 1976. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside the normal pattern of exchange transactions. It should be noted that Rule 19b–3 covers any "rule of the exchange," which is defined as any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges.

Introduction

In view of the importance of the issue of commission rates dealt with by the rule and the extensive consideration given to the subject over the past twelve years, not only by the Commission but by Congressional Committees, the Department of Justice, the Treasury Department, exchanges, various firms and organizations in the securities industry, investors and many independent economists, jurists and other scholars, the Commission believes it is appropriate to set forth the reasons for the rule and the relevant considerations in somewhat greater detail than is its usual practice in connection with the adoption of rules or than appears to be required by the Administrative Procedure Act.[7] At the same time, the voluminous materials on this subject which have been developed and considered since 1963 and the numerous questions with respect thereto which have received the Commission's attention make it impossible, if we are to keep this release within any reasonable compass, to do more than highlight those aspects of the matter which the Commission finds particularly significant. It is therefore impractical to undertake a detailed analysis of the large body of underlying facts which entered into the Commission's determination to adopt the rule.[8]

[7] Section 4(c) of the Administrative Procedure Act (5 U.S.C. 553(c)) provides that rules which are adopted shall incorporate "a concise general statement of their basis and purpose." It is our practice to include such a statement in the release announcing the adoption of a rule. This provision may be contrasted with Section 8(c) of that Act (5 U.S.C. 557(c)), which requires, in the case of adjudication, that the decision include a statement of "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record."

[8] Securities Exchange Act Release No. 11073 of October 24, 1974, in which the Commission released the proposed rule for

More particularly, although the Securities Industry Association raised a question at the *19b–3 Hearings* with respect to the legal authority of the Commission to adopt any rule precluding the exchanges from having rules fixing rates of commission, and similar questions have been raised by others in the past, the Commission does not regard it as appropriate to set forth in this release the legal arguments in support of its authority to adopt the rule. In view of the broad regulatory and rulemaking authority over the securities markets and the securities exchanges, including the specific subject of commission rates, granted to the Commission by the Act, the Commission, after careful consideration of the legal issues, is satisfied that it has authority to adopt Rule 19b–3, if it makes, as it has done, the basic findings called for by the Act.

The Act was passed against the background of the stock market crash of 1929 and in the light of the extensive study and investigation by the Senate Committee on Banking and Commerce entitled "Stock Market Practices." It was consequently a basic, if not the basic, purpose of this legislation to provide for regulation of the stock market and of transactions and practices relating thereto. It was intended that this regulation be comprehensive and complete. Indeed, the Congress so stated in the preamble of the Act which stated that it is "necessary to provide for regulation and control . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective." This objective was approached in a variety of ways. The Commission was established to administer the Act; and exchanges are

public comment, contained a list of some of the more important source materials relating to this subject, which mere list covered two and one-half printed pages. Reference thereto is hereby made.

required to register with the Commission, are charged with the duty of self-regulation of their members and may become registered only if the Commission concludes, among other things, "that the rules of the exchange are just and adequate to insure fair dealing and to protect investors." In addition to statutory provisions regulating various trading practices and activities of members, Section 19(b) of the Act supplements the initial authority of the Commission over exchange rules by authorizing it to alter or supplement the rules of an exchange with respect to various significant matters, including "the fixing of reasonable rates of commission, interest, listing and other charges." The standard for such action is that such alterations be "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." As the House Committee put it, this authority was intended to permit the Commission to effect changes in exchange rules "in any important matter . . . appropriate for the protection of investors or appropriate to insure fair dealing." [9]

In view of the complexity of the subject and of changing conditions, great reliance was placed upon broad rulemaking power so as to enable the Commission to respond flexibly to changing regulatory needs. In light of these considerations, the Commission believes that the express authority granted to it over the subject of commissions which, as the *Special Study* [10]

[9] *Report of House Committee on Interstate and Foreign Commerce on H.R. 9323*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934).

[10] Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

said, are "the lifeblood of the brokerage business today even as in 1972," [11] encompasses the authority to accomplish necessary changes in those rules.

An extensive discussion of the history and interpretation of the Commission's rulemaking authority under the Act is found in Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3902 (Feb. 8, 1973), to which reference is hereby made.

The remainder of this release consists of the following sections:

1. Summary of the Evolution of Exchange Commission Rates and of the Commission's Consideration of Them.
2. Reasons for the Rule.
3. Comments on the Rule.
4. Conclusion.
5. Text of the Rule.

1. Summary of the evolution of exchange commission rates and of the Commission's consideration of them

The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792, which provided:

> We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter percent Commission on the Specie value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May, at New York, 1792.[12]

[11] 2 *Special Study* 295.

[12] Eames, *The New York Stock Exchange* 14 (1894).

Although present exchange commission rate rules have become far more complex than this simple paragraph, the essentials are the same. The members undertake not to deal at a rate less than the fixed commission, that is, the public rate, and to give preference to each other, that is, the intra-member rates. The ancient lineage of exchange rate fixing, and the fact that it has persisted for over a century and a half without serious challenge, naturally provoke inquiry as to why it should be questioned now. The answer is that exchange commission rate fixing operates now in a far different environment than it did in earlier periods. During the period from 1792 to approximately the end of World War I, exchange commission rates were of little public importance. The general public was not involved to any significant extent in exchange trading in equity securities and there was some justification for regarding the stock exchanges as, in considerable measure, private clubs. While certain aspects of exchange operations gave rise to increasing public concern in the late years of the 19th Century and the opening years of the 20th Century, commission rates were not among them.

After the end of World War I, the public participated increasingly in exchange trading in equity securities and the stock market assumed unprecedented importance in the functioning of the economy. The disastrous events of 1929 demonstrated that the exchanges had not satisfactorily adapted to their new status as institutions with far reaching public reponsibilities and led to the comprehensive Congressional investigations of the early 1930's. The evils and malpractices thus uncovered, in turn, gave rise to the movement for reform which culminated in the enactment of the Act in 1934 with its comprehensive scheme of governmental regulation. But attention was then

focused primarily upon such obvious evils as corners, pools, manipulations, insider trading, and other fraudulent and deceptive practices which seriously injured investors. With respect to commission rates, there was some concern with the possible overcharging of unsophisticated investors, and with posible monopoly profits, and the Commission was given regulatory authority.

Between World War II and the early 1970's, the public flocked into the securities markets, and financial institutions increasingly participated in those markets. As a result of Congressional concern as to the adequacy of investor protection under these circumstances, two major studies were made under the auspices of the Commission. The first of these was the monumental *Special Study*, made essentially during the period from the end of 1961 to the middle of 1963, pursuant to Congressional direction embodied in an amendment to the Act. The second of these studies was the *Institutional Investor Study*,[13] made essentially in 1969 and 1970, pursuant to another amendment to the Act. The *Special Study* noted that during the 1952–1961 decade, the number of individual shareholders in America grew almost three times but that, despite this expansion, activity of individuals as a proportion of total NYSE share volume decreased from 57% in 1952 to 51.4% in 1961; during the same period, the *Special Study* observed, institutional activity rose from 24.6% in 1952 and 19% in 1953 to 26.2% of such volume in 1961.[14] The *Institutional Investor Study* noted a further decrease in the volume accounted for by the public to 33.4% at the end of 1969 and an increase in the institutional share during

[13] Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

[14] 2 *Special Study* 6.

the same period to 42.4%.[15] The institutional share has continued to rise at least through 1971, the latest year for which the NYSE has made available a public transaction study.[16]

The *Special Study* included probably the first reasonably comprehensive analysis of the nature and structure of commission rates and their impact, together with the procedures and standards involved in setting and reviewing such rates. The *Special Study* did not, however, consider the question of fixed vs. competitive commissions. Nor did it believe that it was either "called upon or equipped" to study the level of commission rates or to express any view with respect to their reasonableness. Nevertheless, the *Special Study* did point out certain problems presented by the commission rate structure, some of which are still unresolved. These include the fact that the commission rate schedule covers a great variety of services performed by brokers in addition to the execution and clearance of transactions. That characteristic of the rate schedule has induced service competition rather than price competition and has resulted in complex and irrational distinctions between permissible ancillary services and prohibited rebates of the minimum commission. The *Special Study* also noted the prevalence of reciprocal arrangements and pointed out that the nature of the securities commission business is such that traditional principles of rate regulation can hardly be applied to it. In that connection, the *Special Study* said:

> It is important to reemphasize that, while the security commission business shares, with other businesses subject to rate regulation, the qualities of being "affected with the public interest"

[15] *Institutional Investor Study*, Supp. Vol. 1 at 147.

[16] *NYSE 1974 Fact Book* 55.

> and of being limited to a standard of "reasonable" rates, the differences are perhaps more significant than the similarities, and the problem here is in many ways unique. Thus, the public utility normally possesses a franchise conferring upon it monopoly rights to furnish a service required by the public and also obligating it to furnish service to all who need it at reasonable prices. In contrast, though the auction market of the NYSE is a dominant unit in the structure of our capital markets, about 500 member firms compete with each other for the business of the public to be transacted on the NYSE within the confines of the same commission rate schedule. Moreover, they compete with other investment media for the public's savings, and the Exchange itself competes as a marketplace with other markets, both for the listing of issues to be traded and for transactions in listed issues also traded on other exchanges (dually traded securities) or in the over-the-counter market.
>
> There are other important economic differences. Public utilities generally are characterized by relatively high investment in fixed plant and equipment, while the security commission business is essentially a service business requiring relatively small capital investment but relatively high personnel costs. The income of utilities tends to be more stable than that of industry generally while that of the security commission business fluctuates much more widely. These differences make it clear that the problem of "reasonable" rate level can be solved by no simple transfer of principles evolved in the field of utility regulation to the security commission business.[17]

It was further pointed out that a basic dilemma was involved in the setting of commission rates. Tradition-

[17] 2 *Special Study* 328–329 (footnote omitted).

ally, the rates have been set, at least in part, in terms of a commission per share. This means that with a per share commission the commission charge on a given number of shares of a low priced stock is a far larger proportion of the amount invested than the commission on the same number of shares of a high priced stock. On the other hand, a commission schedule based on the dollar amount of the investment would produce a far higher commission on a given number of shares of a high priced stock than on a given number of shares of a low priced stock although the cost of executing the two orders would normally not be very different. In the context of a fixed rate structure, no satisfactory solution to this dilemma was yet been found.

The *Special Study* also pointed out that five commission rate increases occurred between the enactment of the Act and 1963, and that in connection with each reference was made to generalized concepts of cost and profit but that the available data for the determination of these was entirely inadequate and that complex problems of allocation of costs existed as well as the even more difficult conceptual problem of giving content to the general standard of reasonableness in an industry to which traditional ratemaking concepts were largely inapplicable.

Over the years since the *Special Study*, strenuous efforts were made by the Commission and the exchanges to deal with the problems and to correct the defects pointed out. Thus, volume discounts were introduced, customer directed give-ups were abolished, income and expense data for member firms were substantially improved and efforts were made to develop principles for the allocation of costs and also to develop a ratemaking philosophy. It is fair to state, however, that the latter efforts have not been successful. The NYSE has acknowledged that it has not established a basis for allocating costs between the stock exchange commission business and other business done by member firms and has requested the Commission to pass upon recent proposals for rate increases upon the basis of the overall profitability of the securities industry and the impact of inflation upon various costs incurred by member firms. The exchanges and representatives of the brokerage industry acknowledged at the *19b–3 Hearings* that they had not yet endeavored to develop and present a philosophy or a set of principles to be applied in ratemaking.

The Commission has held two major hearings with respect to rate structure since the *Special Study*. The first of these was the *Rate Structure Hearings*[19] commenced in early 1968. In those hearings, the question was, for the first time, directly raised as to whether rate fixing by exchanges should be replaced by competition. The Antitrust Division of the Department of Justice participated in those hearings in order to "raise questions concerning the relationship between * * * the Exchange Act and the public policy embraced in the Federal antitrust laws."[20] In the

[19] *In the Matter of the Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

[20] It is rather surprising that, although the exchanges have been engaged in a combination to fix commission prices both before and ever since the Sherman Act was passed in 1890, the first direct antitrust challenge to stock exchange rate fixing in the federal courts did not come until the *Kaplan* case in 1966. *Kaplan* v. *Lehman Bros.*, 371 F. 2d 409 (7th Cir.), *cert. denied*, 389 U.S. 934 (1967). Perhaps this was, at first, attributable to the early idea that the commerce clause of the Constitution and the Sherman Act applied only to transactions in "commodities." *See Hopkins* v. *United States*, 171 U.S. 578, 597–98 (1898);

course of the hearings, the NYSE stated that it would retain economic consultants to develop a cost-based commission rate schedule. The Commission agreed to await completion of that study before resolving the basic question but, nevertheless, invited written submissions and oral presentations in preparation for the resolution of those issues. In response to the Commission's invitation, the Antitrust Division of the Department of Justice stated, in effect, that the Commission should develop a transitional program which would permit it to institute competitive commissions gradually, commencing with larger volume transactions.[20]

The NYSE study was thereafter accelerated and in February, 1970, the NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange."[21] The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the *February*

United States v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944); *Atlantic Cleaners & Dyers* v. *United States*, 286 U.S. 427 (1932). Since 1934, federal regulation under the Act has affected the application of the antitrust laws to stock exchange actions. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). The status of stock exchange rules fixing commissions under the antitrust laws in view of the provisions of the Act is expected to be clarified by the Supreme Court in the near future unless mooted by enactment of legislation now pending in the 94th Congress. *See Gordon* v. *New York Stock Exchange*, 498 F. 2d 1303 (2d Cir.), *cert. granted*, 95 Sup. Ct. 491 (1974).

[20] *Rate Structure Hearings*. Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure, Jan. 17, 1969, at 194–195.

[21] Hereinafter cited as the *February NERA Report*.

NERA Report and that the *February NERA Report* was merely a study presented for discussion.[22]

The Commission reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the *February NERA Report*, by limiting increases on small orders and decreases on large orders called for in the original study.[23]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, while the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates, it also stated that it was of the

[22] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[23] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, a Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (July 1970) (hereinafter cited as the *July NERA Report*). The *February NERA Report* had proposed a 116.3 percent increase in the commission on an order involving 100 shares of stock selling at $10 per share; the NYSE proposal called for a 50 percent commission rate increase. For an order of 1,000 shares of a stock selling at $50 per share, the *February NERA Report* had proposed a 36.3 percent commission rate reduction; the NYSE proposal called for a 10 percent commission increase. For further comparisons, see Table XI-4 of the *February NERA Report* and Table XII-3 of the *July NERA Report*.

opinion that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. It further requested that a plan for reasonable economic access for non-member broker-dealers be presented.[24]

In March, 1971, the *Institutional Investor Study* was transmitted to the Congress. That *Study* was basically an economic study conducted primarily by economists and it included an examination of the impact of institutional investment upon the securities markets. This aspect of the *Institutional Investor Study* is relevant to the question of commission rates since one of the principal problems with the commission rates was the generally unsuccessful effort to

[24] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). In the course of the *19b–3 Hearings*, reference was made to that release as making the continuation of minimum commissions dependent on the adoption of a uniform system of accounts. While indicating that implementation of a uniform system of accounts, as well as uniform and adequate methods of cost allocation, was necessary to the continuance of a system of fixed rates for exchange transactions, that release also stated that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. The inadequacies of the data submitted in support of the NYSE proposal were subsequently pointed out to the NYSE. *See* letter dated April 23, 1971, from Irving M. Pollack, Director, Division of Trading and Markets, to William C. Freund, NYSE Vice President and Economist. As indicated *supra*, p. 11, exchanges have not established a basis for allocating costs between stock exchange commissions and other business done by member firms. Furthermore, by the end of 1970 it appeared that the banning in 1968 of customer directed give-ups and the simultaneous introduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See* Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also* 4 *Institutional Investor Study Report* 2206.

adapt them to the needs of both individual investors and large institutional investors. Upon the basis of the data and analysis of the *Institutional Investor Study* with respect to this matter, the Commission concluded, as stated in its letter of March 10, 1971, to the Congress in transmitting the *Study:*

> It is clear that the securities markets are changing in rapid and significant ways. There are a number of reasons for these changes; among the most important are the greatly increased volume of trading by institutions, the negotiated nature of many institutional transactions, the fixed minimum commission rates that stock exchanges impose on such transactions and technological advances in communications and data processing. The evolution of the securities markets has been, and may continue to be, affected and distorted by barriers to competition. Among the most significant of these are minimum commission rates and rules that insulate markets, market makers and broker-dealers from each other. The combination of fixed minimum commission rates and barriers to access have tended to cause institutions to choose market places, in part at least, for the purpose of reducing the commission they pay or taking advantage of opportunities to purchase various services with "soft" commission dollars by means of reciprocal practices. These appear to be the most important explanations for the accelerating growth of institutional trading on the regional stock exchanges and in the third market. Because the assembly of many block trades takes place primarily over the upstairs communications systems of broker-dealers rather than on the floor of any stock exchange, such transactions can be executed wherever the participants select, and markets have therefore been selected on the basis of these considerations.

> The fixed minimum stock exchange commission on large orders had led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interests, to be anti-competitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems. The Commission will closely observe the extent to which competitive commission rates lead toward these results.[26]

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for non-member brokers permitting discounts of up to 40 percent from the public rate).[26]

[25] *Institutional Investor Study*, Summary Vol. xxii. *See infra* n. 13.

[26] Securities Exchange Act Release No. 9351 (Sept. 24, 1971).

In not objecting to the NYSE's rate proposal the prior October, the Commission had specifically requested the presentation not alter than May 31, 1971, of a uniform accounting system in order to evaluate the need for a fixed commission rate system.[27] In September, 1971, the Commission recognized that the inability of the NYSE appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms. The Commission, therefore, extended until May 1, 1972, the period for submission of uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals.[28]

Beginning in October, 1971, the Commission held the *Hearings on Market Structure*[29] and, on February 2, 1972, issued the *Market Structure Statement*,[30] which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[31] The *Market Structure Statement* concluded

[27] *See* n. 24 *supra*.

[28] The Commission also indicated that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Release No. 9148 (Apr. 14, 1971).

[29] *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147 (1972).

[30] Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, 37 Fed. Reg. 5286 (Mar. 14, 1972).

[31] The *Market Structure Statement* expressed the unanimous view of the Commission as it was then constituted (Chairman Casey and Commissioners Owens, Needham, Herlong and

that a reduction to $300,000 was called for in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed commission rates for a very long time and that it would, therefore, be appropriate to measure the effect of competitive commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement toward moving toward competitive rates, but concluded that that did not rule out moving toward competitive rates, at least on large orders, at a measured, deliberate pace and that the Commission rate structure would ultimately be based upon the cost characteristics of the service being offered.[32] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

In May, 1973, the NYSE proposed to increase commission rates; the Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed inereases or to their continuation through March 31, 1974.[33] The Commission also indicated that

Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

[32] *Market Structure Statement* 16. The emphasis of the *Market Structure Statement* was on fostering free and open competition, not only with respect to commission rates but also competing market makers.

[33] On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's

it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.[34]

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as resubmitted in amended form by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitive commission rates.[35] The Commission then held the *Intra-Member Rate Hearings,* at which the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[36]

proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974), 39 Fed. Reg. 43250 (Dec. 11, 1974).

[34] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). The NYSE Board of Directors had already adopted on the preceding March 1 a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on national securities exchanges operating under similar rules and regulations.

[35] Securities Exchange Act Release No. 10669 (Mar. 6, 1974).

[36] In Securities Exchange Act Release No. 11019 (Sept. 18, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974), the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates.

During the same period the Committees of the Congress having jurisdiction over securities regulation had also turned their attention to the issue of fixed vs. competitive rates. Both the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs and the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives initiated in 1971 a comprehensive examination of the securities industry. These studies were primarily occasioned by the operational and financial crisis in the securities industry in 1969 and 1970 which had led the Congress to enact the Securities Investor Protection Act of 1970.[37] That Act, in effect, provided government insurance for investors against loss resulting from the insolvency of broker-dealers and created a potential liability of the Treasury to cover such claims. The Committees felt that they should independently study the industry to examine the conditions which made such legislation necessary. Both Committees carefully studied the problems arising from fixed commissions. The recommendations of the Senate Subcommittee contained in its Report of February 4, 1972, with respect to commission rates were as follows:

> The related questions of stock exchange commission rates and exchange membership for institutions have been the subject of intensive hearings before the SEC for 3½ years. A review of the record of these proceedings and of the statements submitted to the Subcommittee itself on these questions reveals clearly that the

[37] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation established by that Act is required to provide for the satisfaction of claims against a bankrupt broker, not exceeding $50,000 for each customer (subject to a limitation of $20,000 for claims for cash).

> present distortions and fragmentation of our securities markets cannot be effectively dealt with so long as the NYSE and other stock exchanges are permitted to fix the commissions that their members must charge, at least on large transactions. The industry expects, and is entitled to, a clear statement of government policy as to when and how the present restrictions will be removed. This requires the setting of a date certain for elimination of fixed rates on institutional-size transactions, which have resulted in the most serious distortions. This could best be achieved by eliminating fixed rates on orders in excess of $100,000. In addition, to provide the possibility of lower rates to small investors, brokerage firms, after appropriate filings with the SEC, should be permitted to charge lower fees for "unbundled" services than are required by the current fixed rate schedules for the full range of brokerage services.[38]

The House Committee in its recommendations went somewhat further, stating that:

> The Subcommittee finds that fixed minimum commission rates are not in the public interest. We have reviewed our own record, the relevant portions of the SEC's record and that of the Senate study. On the basis of that review the Subcommittee finds that the fixed minimum commission rate system should be replaced by one where commission rates are determined by the forces of competition. We find further that competitively determined rates should apply to all transactions regardless of size, and that a competitive commission rate system should be phased in without excessive delay.

[38] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs (For the Period Ended Feb. 4, 1972)*, 92d Cong., 2d Sess. (1972).

The SEC has indicated that it will seek reduction of the level from $300,000 to $200,000 by April of 1973 and then to $100,000 by April of 1974. The New York Stock Exchange has proposed a slightly different timetable, and stated that it will review the level for competitively determined commission rates in October 1972.

The Subcommittee has heard testimony that the difference in impact on the industry between a $500,000 breakpoint and a $300,000 breakpoint is minimal, and a number of witnesses indicated that a further reduction in the breakpoint may be warranted prior to the date scheduled by the SEC. The Subcommittee agrees. A further reduction in the breakpoint by the Exchange when it conducts its review in October is warranted. The SEC could then adjust its timetable accordingly. So long as reasonable progress along this road is being made, the Subcommittee will defer legislative action.

The Subcommittee agrees with the testimony of a large number of witnesses that there is no reason to freeze competitive rates at the $100,000 level. The Subcommittee finds no logical justification for competition on institutional size transactions while perpetuating rate fixing on transactions of small investors. If steps are not taken to continue to reduce the breakpoint below the $100,000 level until all fixed rates are abolished, the Subcommittee will introduce legislation to do so.

There has been much debate over the desirability of a fixed minimum commission rate system. But the Congress, the Department of Justice, and the SEC have determined that the public interest will best be served by replacing fixed prices with a competitive rate system. The debate should now end. If the securities industry expends as much energy in adjusting to a competitive system as it has in debating its

wisdom, the Subcommittee is convinced that the industry will not only survive, but it will flourish.[39]

Following the completion of these *Studies,* legislation to implement the recommendations of the respective Committees was introduced in the Senate and in the House. The Senate bill passed the Senate but the House bill, although favorably reported by the Committee on Interstate and Foreign Commerce, was not acted upon in the 93d Congress. Similar legislation has been introduced in both Houses in the 94th Congress.[40]

2. Reasons for the rule

The basic reason for the Commission's decision to adopt Rule 19b–3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the public interest than any system of price fixing which can reasonably be devised. Furthermore, the Commission concludes that there is no economic requirement for fixed rates of commission in the securities industry, as is evident from the practical experience of the over-the-counter market, where no such structure exists, as well as all of the data which has been accumulated concerning the nature and characteristics of the securities commission business.[41] Consequently, even if it were possible to

[39] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce,* H.R. Doc. No. 92–1519, 92d Cong., 2d Sess. (1972).

[40] H.R. 10 and S. 249, 94th Cong. 1st Sess. (1975).

[41] The securities commission business, of course, is not a natural monopoly or utility which requires fixed rates because price

devise a better scheme of fixed rates, the commitment of resources would not appear to be justified under present and foreseeable conditions in view of the strong probability that no such system would work as well as competition. The foregoing conclusions are consistent with the American tradition of reliance upon free competition to determine prices and allocate resources, as reflected by the public policy embodied in the antitrust laws. It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons.

The existing commission rate structure has demonstrably worked badly during that period. It has led to distortions, evasions, conflicts of interest,[42] and

competition is impossible. It is, however, contended that the securities commission business is of so vulnerable a nature that it cannot survive price competition or, stated otherwise, that it is subject to "destructive competition." Certain reasons for rejecting that conclusion are discussed under the next heading in this release.

[42] The fixed rate structure tends to create conflicts of interest on the part of institutional investors who are usually engaged in managing investments on behalf of others, rather than investing their own money. In these cases, the institutional manager allocates the commission business among brokers but the beneficiaries, in effect, pay the commissions. Since brokers provide a great variety of services which are compensated by commissions, institutional managers are constantly tempted to direct

inefficiencies, and has obstructed at every step the ability of the securities markets to adapt themselves to the demands of our time. It has impeded the evolution of a central market system and has fragmented the markets, impairing their ability to concentrate the flow of orders and to mobilize marketmaking resources necessary to provide depth and liquidity in a market increasingly affected by institutional participation.

It has also, by its rigidity and delay, inhibited innovations in the rendering of brokerage services to the investing public and in the ability of the securities industry to adjust rapidly to the rapid fluctuations in the volume of trading and, therefore, in the demand for brokerage services. Some of these difficulties seem to be inherent in a fixed rate system as applied to a dynamic and rapidly changing industry.

When the Commission commenced its inquiry into the commission rate structures at the time of the

the brokerage business of their beneficiaries to brokers who will provide services for the benefit of the manager. The problem is aggravated by the fact that under prevailing accounting practices and tax law, commissions are treated as part of the purchase price of securities bought, or as a deduction from the proceeds of securities sold, rather than being accounted for as expenses incurred in the management of the portfolio. Under these circumstances, investment managers may be inclined to seek services in exchange for brokerage since the cost of such services may be buried in the carrying value of the portfolio securities rather than charged to the beneficiaries as an expense of administration. The tendency of this situation to corrupt fiduciary relationships is not the least of the evils resulting from the present commission rate system. Even where no misconduct is present, the situation leads to inefficiency in the management of assets. The foregoing does not mean that fiduciaries may not utilize commissions on transactions for beneficiaries to obtain for their beneficiaries research and other valuable services. Certain aspects of this matter are discussed below in connection with the so-called "fiduciary question" raised by certain persons in connection with the proposed rule.

Special Study, fixed commission rates were assumed by everyone, including the Commission, to be a normal and necessary feature of the exchange markets. It became more and more clear in the light of later experience that this was not the case. However, the virtues of the traditional system were staunchly defended throughout the Commission's hearings in 1968 and 1969 and in the hearings before Congressional Committees in 1971 and 1972. In contrast, at the *19b–3 Hearings,* the existing system had few defenders. Those who opposed the proposed rule largely confined themselves to either asking for delay, or suggesting that the initiation of competitive commission rates should await a more prosperous period, or be deferred pending the taking of certain further steps toward a central market system, or the adoption of certain proposed safeguards for the auction market process.[43] A few witnesses suggested that some vaguely outlined better system of fixed commission rates should be developed. No one supported any extended continuation of the status quo at least with respect to public rates.

The foregoing does not reflect any judgment by the Commission that the fixed minimum commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to earlier that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary.

[43] *See infra* "Comments on the Rule."

3. Comments on the rule

In addition to a number of comments urging prompt adoption of Proposed Rule 19b–3,[44] a number of comments were recived either opposing its adoption or suggesting changes in timing to allow for other developments or to await improved economic conditions, or urging that other action be taken by the Commission in conjunction with its adoption. The princi-

[44] *See, e.g.*, statements at *19b–3 Hearings* by Representative William S. Stuckey, Jr., United States House of Representatives; James H. Lorie, Professor of Business Administration, University of Chicago; Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Marshall E. Blume, Professor of Finance, University of Pennsylvania; Donald Farrar, Professor of Finance, University of California, Los Angeles; Walter Werner, Professor of Law, Columbia University; Richard West, Dean, University of Oregon; David L. Ratner, Professor of Law, Cornell University; Robert Loeffler, Trustee, Equity Funding Corporation of America; James B. Halpern, of Arent, Fox, Kintner, Plotkin and Kahn; Philip G. Conner, Executive Vice President of Conner, Redwine, Inc.; Mark M. Batatian, President, Prudential-American Securities, Inc.; Charles T. Bauer, Chairman, Committee of Investment Officers, American Insurance Association. Comments of the United States Department of Justice, Dec. 10, 1974.

In addition, a number of letters supporting prompt adoption of the rule were received subsequent to the *19b–3 Hearings. See, e.g.*, letters from Senator Harrison A. Williams, Jr., Chairman of the Senate Subcommittee on Securities (Dec. 16, 1974); Senator Philip A. Hart, Chairman of the Senate Subcommittee on Anti-trust and Monopoly (Dec. 17, 1974); Representative John E. Moss, Chairman of the House Subcommittee on Commerce and Finance (Dec. 16, 1974); Representative Peter W. Rodino, Jr., Chairman of the House Subcommittee on Monopolies and Commercial law (Dec. 18, 1974); and William R. Salomon, Salomon Brothers.

pal arguments for permitting fixed minimum commission rates to continue were the contentions that the brokerage industry is subject to "destructive competition," that the fixed commission rate structure provides desirable subsidies which cause the securities markets to operate more efficiently and fairly and that the existence of a fixed commission rate, by encouraging membership on exchanges, is desirable to promote self-regulation.

The proposition that the brokerage industry, if subjected to competitive commission rates, would be susceptible to destructive competition was first elaborated in 1968; and it was again urged, in opposition to Rule 19b–3. The economic prerequisites for the type of destructive competition postulated are, however, the existence of fixed costs constituting a high percentage of total costs, and the availability of economies of scale applicable to a substantial percentage of an industry's aggregate production. Under those circumstances, it is argued that price competition, during periods of low demand and excess capacity, may be expected to drive prices down to marginal costs, which would be below average costs, resulting in losses for a large part of the industry. Eventually such conditions would result in a contraction of industry capacity to a level below that which is necessary to supply the public need and an undue degree of concentration in the brokerage industry which would have adverse effects on the functioning of the securities markets.

The possibility of destructive competition in the brokerage industry has been, since 1968, subject to careful analysis by a number of independent economists.[45] These analyses demonstrate that the brokerage

[45] *See, e.g.*, Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stanford L. Rev. 675 (1970);

industry's fixed costs are not high in relation to its total costs even though fixed costs have sharply increased since 1968 and that there are no economies of scale which should lead to undue concentration with competitive commission rates. It has also been pointed out that, above a critical level necessary to provide modern electronic facilities by contract or otherwise, other forms of competition such as service competition could be expected eventually to have effects similar to those of price competition so that a fixed commission rate system, absent controls on the type and quantity of services, does not assure that there will not be increasing concentration in the brokerage industry.[46] Experience with competitive commission rates on large transactions since April, 1971, and on small transactions since April, 1974, has tended to bear out the analysis that the brokerage industry is not subject to destructive competition as postulated.

Coupled with the destructive competition argument has been an acknowledgment that any now fixed commissions would have to be based on costs with suggestions that the Commission develop the necessary analysis. To date the exchanges have not devised a system for allocating costs between stock exchange commission business and other business not involving fixed rates; furthermore, they have been reluctant to adopt schedules recommended on the basis of available cost

Friend and Blume, *Competitive Commissions on the New York Stock Exchange*, 28 The Journal of Finance 795 (1973); Mann, "A Critique of the New York Stock Exchange's Report on the Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities, and the Investing Public" *Rate Structure Hearings* (1969); West and Tinic, *Minimum Commission Rates on New York Stock Exchange Transactions*, 2 Bell Journal of Economic and Management Science 577 (1971).

[46] *See* Friend and Blume, *supra* n. 43.

data.[47] A number of brokerage firms have repeatedly indicated that it is impractical to allocate expenses so as to break down net income among such varied lines of business as securities commissions, underwriting and trading profits since substantially the same sales personnel and branch office facilities are engaged in the generation of all sources of revenues at any time, and it is not practicable to allocate to each revenue source its share of such joint expenses as personnel costs, occupancy and equipment costs, interest and communication costs.

On the basis of its experience over the last six years with the problems of analyzing costs for a brokerage industry in many different lines of business, the Commission has concluded, as noted above, that commitment of resources would not be justified in view of the strong probability that no such system would work as well as competition.[48] The brokerage industry has demonstrated for a number of years that it can deal with price competition. Initially, such competition was confined to the use of the complex rebative practices which developed because the fixed commission rate structure was out of line with perceptions of cost. Since April, 1971, competitive commission rates for large transactions have been given formal recognition in the rate structure, and since April, 1974, competitive commission rates have been in effect for small transactions.

The second argument for retaining fixed commission rates is that they provide a number of subsidies which are beneficial to the operation of the securities markets.[49] Thus, it is said that large investors should pay

[47] *See supra* n. 22 and accompanying text.

[48] *See supra* "Reasons for the Rule."

[49] *See, e.g., Statements at Intra-Member Rate Hearings* by representatives of the NYSE, the American Stock Exchange, and the Securities Industry Association; and Satements at *19b–*

commissions which are in excess of those justified by costs thereby enabling brokers to hold commission rates for small investors down to reasonable levels. The participation of small investors, which would be encouraged by lower commission rates would, it is asserted, enhance the orderliness and liquidity of the market for securities.

Many brokerage firms, however, concentrate on servicing large institutions while others concentrate on a retail business for small investors. Firms that do both a retail business and an institutional business have tended to treat the two as separate operations; each operation is in effect selling a different product and selling it to customers with fundamentally different needs. Brokerage firms are not obligated to do business at the request of the public and may decline, for example, to handle the accounts of small customers. Consequently, revenues derived from institutional business do not provide any rational, controllable subsidies to small investors.

It has also been argued that minimum commission rates, since they provide a relatively dependable stream of revenue to regional brokers, particularly small brokers, enable them to operate profitably. Their continued existence is said to be dependent on profits derived from fixed commission rates and to be important in order to maintain a nationwide distribution network for newly issued securities as well as to provide regional underwriting capabilities for local enterprises. While it may be argued that commission rates should be kept artificially high to sustain regional brokers in times of few underwritings so that they

3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Association for the Preservation of the Auction Market, Inc., the NYSE, the American Stock Exchange, and the Securities Industry Association.

may be available when needed to distribute new offerings, underwriting is recognized as profitable business for a brokerage firm, there have always been adequate resources to devote, in light of the demand, to underwriting activities and many regional brokers appear confident of their ability to operate without minimum commission rates. Nevertheless, it is possible that some firms are not large enough to operate efficiently. To that extent there may be a continuation in the current pattern of consolidation of firms after the introduction of competitive commissions.

It has also been argued that minimum floor brokerage commissions are desirable because they maintain excess capacity on exchange floors during slack periods in order to meet peak demands. There are not, however, concomitant obligations on exchanges or their members to maintain any particular level of floor brokerage capacity. Consequently, capacity is not maintained except to the extent that individual exchange members believe it desirable in order to meet expected demand.

With respect to market making by specialists, it is argued that floor brokerage income realized from high volume securities enables the specialist to make a better market in low volume securities. But it has never been possible, in the view of exchanges and specialists, to measure the quality of markets with any degree of precision so as to determine that any incentive provided by minimum floor brokerage commissions is being used to provide better markets. It has consistently been acknowledged that the type of market maintained for a security is dependent upon its individual trading characteristics which may vary from time to time so that there is not any way to monitor the use by specialists of any incentive provided. Furthermore, the system of allocating and reallocating stocks to specialists has not been designed for the purpose of distributing floor brokerage among different specialists on any basis likely to make efficient use of the incentive. Secondly, securities listed on exchanges are required to meet listing criteria designed to provide reasonable likelihood of sufficient trading volume so that the exchange system will operate effectively.

The third argument for maintaining fixed commission rates is that they provide an incentive for membership on exchanges and that the exchange revenue derived from the orders executed on exchanges supports desirable self-regulation of the brokerage industry. The advent of competitive rates, it is argued, may lead to an exodus from exchanges of members which could effectively negotiate access to the exchange when necessary and would otherwise make separate markets off the exchanges.

Market making requires the commitment of capital so that, to the extent exchanges operate as efficient market places, brokers will be less likely to make the necessary investment to engage in their own market-making activities. With respect to the possible loss of membership in the case of brokers which prefer to negotiate access to exchange facilities, exchanges have authority to provide appropriate regulation for such transactions. Furthermore, exchanges may impose revenue charges to support their activities which, if not borne directly by brokers which negotiate access, will nevertheless be passed on indirectly to them through charges made by members. If transactions in listed securities take place off exchanges to a greater extent than is now the case, the associated self-regulatory costs will be shifted to a national securities associa-

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tion. Finally, developments of this kind are among the matters which may be monitored and dealt with if they arise, as discussed below.[50]

Representatives of several exchanges, as well as several other witnesses at the *19b–3 Hearings*,[51] suggested that current economic conditions should lead to a postponement of the introduction of competitive commission rates. It is argued that the transition should be timed to a period of general prosperity so as to allow the securities industry a margin for error in making the necessary adjustments for competitive commission rates. There is not, however, any assurance of successfully predicting the general level of the economy, or of stock volume and stock prices. Furthermore, if a decision were to be made on the basis of predictions, after the decision became effective there could be a change in the trend of the economy, or of stock market volume and stock prices independent of the general state of the economy.

Similarly, there have been recent periods of high stock market volume and stock prices when it would have been unwise to introduce competitive commission rates; during the paperwork crunch in 1969 and 1970 there might have been substantial risks to investor protection, notwithstanding relatively high volume and prices for most of that period. Developments since

[50] Furthermore, with the advent of the consolidated tape, any broker choosing to make its own markets in listed securities would have to ensure appropriate reporting. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341, 356 (1963), with respect to regulation by exchanges of non-members.

[51] *See, e.g.*, statements at *19b–3 Hearings* by Sanford I. Weil, Chief Executive Officer, Shearson Hayden Stone, Inc.; James M. Roche, Public Director of the NYSE; and representatives of the American Stock Exchange, Midwest Stock Exchange and the Securities Industry Association.

1970, such as implementation of the Securities Investor Protection Act,[52] revision of financial responsibility rules,[53] implementation of new rules with respect to custody of customer funds and securities [54] and improved surveillance procedures [55] have substantially reduced those risks.

On the other hand, some commentators suggested that there would be a better opportunity to observe adverse consequences, if any, and take action to correct them during a period of relative lack of activity in the industry. Finally it was suggested by others that there would be transitional problems of roughly the same magnitude whenever the transition took place, and, therefore, no effort should be made to tie the transition to particular economic circumstances.[56]

The most important consideration is that the brokerage industry should be given, as it has been, a substantial period of time to plan for the transition rather than attempt to time the change precisely with respect to particular economic circumstances. That was the principle which motivated the Commission to announce, in September, 1973, its policy conclusion

[52] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974).

[53] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[54] Rule 15c3–3 under the Securities Exchange Act of 1934, 17 C.F.R. 240.15c3–3.

[55] *See* Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16–17 (1974).

[56] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University, and Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

that the fixing of commission rates should be terminated after April 30, 1975.

It was also urged that a number of other steps be implemented concurrently with or prior to the introduction of competitive commission rates. Suggestions included: (a) adoption of a best execution rule;[57] (b) development of a composite quotation system and improved nationwide clearance and depository system;[58] (c) possible safeguards to maintain viability of regional exchanges and third markets;[59] (d) preservation of the auction market by providing "equal regulation" for aspects of the securities business;[60] (e) alteration of other rules of exchanges which have anti-competitive aspects;[61] (f) prior action to lower costs on small transactions;[62] (g) prohibition of affil-

[57] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Donald Farrar, Professor of Finance, University of California, Los Angeles; and representatives of the Boston Stock Exchange.

[58] *See, e.g.*, statements at *19b–3 Hearings* by Daniel J. Murphy, Senior Vice President, Shields Model Roland, Incorporated; and representatives of the Boston Stock Exchange, Midwest Stock Exchange and PBW Stock Exchange, Inc.

[59] *See, e.g.*, statements at *19b–3 Hearings* by Donald Farrar, Professor of Finance, University of California, Los Angeles; Mark Batatian, President, Prudential-American Securities, Inc.; and representatives of the PBW Stock Exchange, Inc., and the Investment Counsel Association of America.

[60] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and representatives of the Midwest Stock Exchange and the NYSE.

[61] *See* statement at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

[62] *See, e.g.*, statements at *19b–3 Hearings* by Mark Kaplan, President, Drexel Burnham & Co., Inc. and Thomas E. O'Hara, Chairman of the Board of Trustees of the National Association of Investment Clubs.

iated business;[63] (h) adoption of rules to resolve possible questions as to the scope of the term "investment adviser" under the Investment Advisers Act of 1940 and of the term "member" under the Act;[64] (i) action to clarify the "fiduciary" question;[65] and (j) institution of a monitoring system to assess the impact of competitive commission rates.[66]

Some of the suggestions are intended to have the effect of preserving the competitive position of exchanges; others are designed to remove competitive disadvantages which are believed to impede the ability of existing participants in the securities markets to compete effectively without fixed minimum commissions. Still other suggestions link anticipated de-

[63] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Midwest Stock Exchange.

[64] *See, e.g.*, statments at *19b–3 Hearings* by Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; and representatives of the Midwest Stock Exchange.

[65] *See e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; Haig Casparian, Vice President and General Counsel, William D. Witter, Inc.; Philip G. Conner, Executive Vice-President, Conner, Redwine Inc.; Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Daniel J. Murphy, Senior Vice President, Shields Model Roland Incorporated; Mark Kaplan, President, Drexel Burnham & Co. Incorporated; Honorable Gerald L. Parsky, Assistant Secretary of the Treasury for Trade, Energy, and Financial Resources Policy Consideration; Marshall Blume, Professor of Finance, University of Pennsylvania; James H. Lorie, Professor of Business Administration, University of Chicago; Robert Loeffler, Trustee, Equity Funding Corporation of America; and representatives of the Boston Stock Exchange, Midwest Stock Exchange, NYSE, American Insurance Association and Investment Counsel Association of America.

[66] *See, e.g.*, statements at *19b–3 Hearings* by representatives of the NYSE.

velopments in the efficient operation of the securities markets to the issue of competitive commission rates or anticipate problems with respect to the fair and orderly operation of securities markets.

With respect to adoption of a best execution rule, the Commission does not believe it necessary, solely because of the introduction of competitive commission rates, to formulate special principles to supplement existing standards as to the duty of loyalty and care owed by an agent to his principal under general principles of agency law, as currently supplemented by the provisions of the Act and the rules adopted thereunder. If, however, it should appear appropriate, after the introduction of competitive commissions and on the basis of experience with the evolution of the markets, to provide more particular rules, the Commission will consider doing so.

More efficient and wider dissemination of quotations as well as full implementation of the consolidated tape now in a trial phase, continue, in the Commission's judgment, to be appropriate in the context of the development of a central market system. In the view of the Commission the essence of the central market system is an interconnected system of communication. But the development of such a system or further improvements in the nationwide clearance and depository systems are not preconditions to the introduction of competitive commission rates; rather, competitive commission may, as suggested by some,[67] speed progress in their development.

While regional exchanges have been innovative and resourceful in developing new techniques and services for their members, some of them have also been ve-

[67] *See* statement at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago.

hicles for the evasion of minimum commissions. At least one regional exchange has indicated its confidence that it will be a viable marketplace without minimum commissions,[68] and the Commission does not believe it appropriate to afford special safeguards to regional exchanges solely to protect them against the effects of competitive commissions rather than for reasons relating to a desirable market structure. Similarly, to the extent that the third market has in effect existed because of the exchange umbrella of the minimum commission rate structure, the Commission does not therefore conclude that special protections are appropriate for the third market to further the objectives of the Act.

Suggestions for "equal regulation" for all aspects of the securities business came specifically from the NYSE. The NYSE would, among other things, require all trading in listed securities to be exposed to the auction market provided by any exchange[69] and would limit contact between dealers in listed securities and their customers as is currently done for specialists by NYSE and American Stock Exchange rules. The NYSE and American Stock Exchange rules restricting specialists from certain classes of customers have their regulatory foundation on the specialist's control of the limit order book from which he derives substantial income acting as an agent for other brokers. Similar circumstances do not exist for third

[68] *See* statement at *19b–3 Hearings* by representatives of the Midwest Stock Exchange.

[69] The Midwest Stock Exchange suggested requiring all trading of listed securities to be done on exchanges if exchange memberships dropped. Currently NYSE rules provide in a number of situations that a member need not take even its own transactions in listed securities to an exchange floor. *See* NYSE Rules relating to secondary distributions.

market dealers. Nevertheless, without such provisions it is suggested that the third market will expand to the detriment of the exchanges and the auction market they provide.

Other commentators have suggested that it is more reasonable to argue that minimum commission rates have had more to do with fostering the development of the third market than to argue that competitive rates will make the third market more important.[70] Since the effect of proposals to restrict third market dealers would be to put the third market out of business and consequently give exchanges a monopoly on trading in listed securities, such action would not appear to be appropriate without persuasive evidence based on experience with competitive commission rates that the objectives of the Act would thereby be promoted.

Alteration of other rules of exchanges which have anticompetitive effects was also suggested by commentators particularly concerned that regional exchanges might not survive in an environment of competitive commission rates. One commentator suggested requiring the NYSE to allow anyone to become a specialist in order to develop a system of competitive specialists on the NYSE. That suggestion is based on assumptions about future developments in the markets for listed securities as a consequence of introducing competitive commission rates; those developments may not come to pass and the Commission does not believe it necessary to take specific action in advance of any experience with actual developments.

[70] *See, e.g.*, statements at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago, and Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

With respect to small transactions, it may not be possible to reduce costs without changes in the manner in which securities transactions are effected; certain kinds of costs do not vary with the amount involved in a transaction and must be incurred. To the extent, however, that better cost controls and improved procedures for processing transactions, including the elimination or immobilization of stock certificates, can be developed, their development will be speeded by the introduction of competitive commission rates and impeded by retention of a minimum commission rate system in which rates are automatically increased to pay for increasing costs.

It was also urged that, prior to implementation of a system of competitive commission rates, any handling of affiliated business by exchange members should be prohibited outright in place of the current provisions of Rule 19b–2[71] which require that 80 percent of an exchange member's business not be affiliated business. In adopting Rule 19b–2 the Commission recognized that it should gain some administrative experience in its operation and impact so that it might reassess its position should harmful, unforeseen consequences arise. The current formulation provides flexibility to respond to any fundamental changes attributable to operation under competitive commission rates, which will greatly reduce the significance of the so-called "institutional membership" problem.

The fiduciary question referred to above, arises out of the expectation by many observers that institutional portfolio managers, who purchase a very large part of all brokerage services, may believe themselves compelled, after the introduction of competitive commission rates, to seek the lowest available commission rate. It is believed that institutions would so act out of

[71] 17 C.F.R. 240.19b–2.

fear of lawsuits alleging breach of fiduciary duty if they used their beneficiaries' funds to pay more than the lowest available commission rate. Paying the lowest available commission rate would, it is argued, protect the institutional portfolio manager from liability. Fiduciaries, however, purchase other services for their beneficiaries without believing themselves compelled to seek the lowest possible cost; rather they appropriately "consider the full range and quality" of the services which accrue to their beneficiaries and "need not solicit competitive bids." [72]

In this connection, it has been suggested that fiduciaries might feel compelled to pay commissions which were so low as to make it impossible for brokers to supply research which is urgently needed by these fiduciaries and their beneficiaries. The Commission does not believe that this will occur to any material extent since fiduciaries are entitled to exercise their judgment as to what is in the interest of their beneficiaries and, in any event, the cost of research does not appear to be so large a part of the expense incurred by brokerage firms as to make it impossible for them to supply it in reasonable quantity if their customers desire it.[73] While there may be some period

[72] *Cf.* Securities Exchange Act Release No. 9598 (May 9, 1972), 37 Fed. Reg. 9988 (May 18, 1972).

[73] Member firms' 1973 NYSE Income and Expense reports (which include an estimate of research expense covering all research activities wherever performed) show that, of the 235 firms carrying public customer accounts, 4 estimated research expense as 25 percent or more of total expense, 12 or more than 15 percent, and 26 firms as more than 10 percent. The aggregate research expense of these 26 firms was $20 million out of a total of $100 million for all 235 carrying firms. There were 180 firms for which research expense was estimated to account for less than 5 percent of total expense; but the research expenditures of these firms accounted for 65 percent of the total for all carrying firms.

of adjustment for fiduciaries after the introduction of competitive commission rates for all transactions, experience has to some extent already built up in arriving at commissions on the portion of orders over $300,000, which have most frequently involved fiduciaries. That experience should eventually be capable of general application.

Questions relating to the definition of investment adviser under the Investment Advisers Act of 1940 may require analysis based on experience with competitive commission rates. The questions raised relating to the scope of the definition of member under the Act are not basically new, but were not considered to require specific action in connection with the introduction of access provisions for non-member brokers. The Commission, as indicated below, is, however, prepared to consider further specific proposals with respect to those questions as well as the fiduciary question and other suggestions made at the *19b–3 Hearings*.

The Commission was also requested to undertake a monitoring system to assess the impact of competitive commissions. The Commission proposes to take steps to provide appropriate increased monitoring of the activities of brokers, and their financial condition and operations as well as possible shifts in patterns of trading for some period subsequent to May 1, 1975, in order to assure that the objectives of the Act, including the protection of investors and the maintenance of fair and orderly markets, are upheld during any transitional phase. Such monitoring may include collection of additional financial data as well as programs of staff interviews to evaluate changing conditions. In that connection the Commission will welcome specific suggestions for the types of activities on which monitoring efforts should be focused. In addi-

tion, the Commission will consider whether or not any rulemaking or other action would be appropriate to clarify the application of the definition of member in order to assist exchanges in performing their self-regulatory role and will consider questions as to incentives to exchange membership and problems for fiduciaries anticipated by some commentators. As to the fiduciary question the Commission will, of course, also submit comments on provisions in pending legislation.[74] Any such action, if appropriate, could be taken prior to May 1, 1975, in order to facilitate the transition.

Stated differently, certain persons suggested that the introduction of competitive rates would have undesirable and unintended consequences, in part because of the changes which it would create in the economic incentives and choices of member firms. The Commission believes that these concerns appear exaggerated. In any event, however, the possibility of such undesirable consequences does not provide an adequate basis for deferring competitive rates, since there are other ways in which these problems can be dealt with. The monitoring efforts which the Commission intends to undertake will enable it to be alert to developments and to position itself to take prompt corrective action if undesirable consequences develop before, or after, May 1, 1975. Thus, for example, if it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors.

In that connection, the Commission intends shortly

[74] H.R. 10 and S. 249, 94th Cong., 1st Sess. (1975).

to announce procedures by which any interested person may offer suggestions concerning appropriate methods to deal with any problems that might emerge. It should be noted, however, that proposals which appear on their face to be anticompetitive, can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate.

4. Conclusion

After a long and careful consideration of the policy questions raised by the existence of the fixed commission rate structures on national securities exchanges, the Commission has concluded that the adoption of Securities Exchange Act Rule 19b–3, precluding exchanges from fixing the rates of commission their members must charge, is necessary or appropriate for the protection of investors, to assure fair dealing in securities traded in upon such exchanges and to insure the fair administration of such exchanges, and, accordingly, hereby adopts Rule 19b-3.

5. The text of the rule

The text of Rule 19b–3, as adopted, is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each such exchange shall provide in its rules of the exchange that nothing therein or in

its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the changing of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for a combination of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 9351

The Securities and Exchange Commission today announced that it has sent the following letter to the New York Stock Exchange in response to the latter's commission rate proposal of June 28, 1971:

SEPTEMBER 24, 1971.

MR. ROBERT W. HAACK,
President, New York Stock Exchange,
New York, N.Y.

DEAR MR. HAACK: The Commission has reviewed the proposed commission rates submitted by the New York Stock Exchange on June 28, 1971 pursuant to Rule 17a–8 and in light of the evidence presented at the public hearing on the proposal. As the Exchange has recognized, a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates. Accordingly, the Commission expects that the Exchange will review its commission rate structure on a regular and systematic basis and will submit any appropriate modifications or changes in such structure to the Commission to enable it to exercise its continuing regulatory oversight. The Commission expects the Exchange to con-

tinue to gather necessary data from its members for this purpose. The Commission will also continue its monitoring program in order to assess the need for any rate changes.

As regards the present rate proposal, the inability of the Exchange appropriately to allocate costs and revenues between brokerage and other activities of its members has necessitated our consideration of the proposed rates on the basis of the total financial experience of Exchange member firms. We have considered the problems experienced by the securities industry in dealing with widely fluctuating volume levels in recent years, leading to back office problems and, in some cases, the insolvency of member firms. We find that the profitability of member firms during the first half of 1971 appears to be reasonable in view of significant changes in the operation and structure of the industry, including the introduction of competitive rates on certain large transactions, the forthcoming rules to protect customers' funds and securities and greater access by nonmember broker-dealers to the facilities of the Exchange. The Commission is continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. Accordingly, we reserve this matter for later determination in light of the evidence which is being developed.

On the basis of the evidence presented to us and the factors discussed above, the Commission does not object at this time to implementation of the Exchange's proposed rates, subject to the following conditions:

1. The present surcharge on certain transactions will be terminated as to all such transactions as soon as the Exchange, consistent with price restrictions referred to in subparagraph 10, may implement the new rate proposal.

2. In order to provide small investors with the continued opportunity to participate in the securities markets, no member organization that has traditionally handled small customer accounts will impose or continue any limitation of any kind on the size or frequency of any such customer's orders or the size of his account, nor will any member organizations impose fees, commissions or other charges on any such customer in excess of the proposed rates. The Exchange will establish an Investors' Service Bureau to assist small investors to participate in the markets, and will undertake a comprehensive and continuing effort to facilitate service to the small investor.

3. The rate schedule will be revised to provide that the total commission on an order consisting of a round-lot plus an odd-lot will not be higher than the commission on the next higher round-lot.

4. The intra-member rate will be reviewed by the Exchange in order to determine whether fixed charges should continue to prevail in this area. As regards the intra-member rate incorporated in the NYSE rate proposal, the Commission does not object at this time to that part of the proposal subject to the continuing consideration and review of the long-run desirability of the continuation of fixed intra-member charges and to the Commission's consideration of the industry structure questions in the hearings commencing October 12, 1971 and to the other conditions noted below.

5. The Commission finds that the provision for 30% access is inadequate and that the discount afforded nonmember broker-dealers should be not less than 40% to allow for a minimum meaningful test of this proposal. The Commission is reserving its final deter-

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mination regarding the "primary purpose" limitation of the access provision until the completion of its scheduled hearings. The Commission will reconsider the access provision, including its "primary purpose" limitation, after the conclusion of the hearings scheduled to begin October 12, 1971. The Commission finds inappropriate the condition that it enforce the anti-rebate provisions of the Exchange's agreements for access by nonmembers. The responsibility for enforcing a rule adopted by a self-regulatory organization lies with that organization and the Commission's regulatory oversight will be exercised only to ensure that the rule and its administration by the self-regulatory organization are appropriate.

6. The Exchange will continue to ensure that commission revenues are prudently applied by all member organizations so as to improve further their capital positions and operational facilities.

7. The Exchange will, on or before May 1, 1972, submit to the Commission its proposals for implementing uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals, if the Exchange is unable to devise a suitable reporting mechanism, the Commission will consider doing so pursuant to Section 17(a) of the Securities Exchange Act.

8. The Exchange will examine its definition of an "order" to determine whether to alter the present provision so that portions of the same order executed on different days would be aggregated for purposes of ascertaining the applicable commission rate.

9. The Exchange will adopt rules or rule changes to enable member firms to enter into cooperative arrangements under which execution and clearance functions of such firms could be performed jointly without the payment of intra-member rates for such functions to any other member.

10. The Exchange will comply with any restrictions on price increases imposed by law, as interpreted by the President's Cost of Living Council or any other organization designated by the President or the Congress to impose or interpret any such restrictions.

Sincerely yours,

WILLIAM J. CASEY,
Chairman.

Before the Securities and Exchange Commission,
Washington, D.C.

FILE NO. 10-54-1

PROPOSED RULES OF THE CHICAGO BOARD OPTIONS EXCHANGE

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

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JANUARY 15, 1973.

The Commission has requested public comment on the proposed rules of the Chicago Board Options Exchange, Inc. ("CBOE") which is seeking registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934. In response to this invitation, we wish to comment on proposed Rule 14 which fixes minimum rates of commission for transactions executed on the CBOE.[1] We believe that this rule is subject to serious objection on antitrust and public policy grounds.

[1] Our silence with respect to the other proposed rules of CBOE implies neither approval nor disapproval.

The Commission is well aware that fixed minimum rates of commission raise serious questions under the antitrust laws. *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971). Based on evidence accumulated by the Commission and the courts, the Department of Justice has taken the position that fixed minimum rates are not necessary to achieve any goal of the securities laws and therefore violate the antitrust laws under the doctrine of *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963). We have expressed this opinion in several memoranda submitted to the Commission during the last five years' commission rate and market structure proceedings[2] and have actively advocated this position as a party to the *Thill* litigation. In addition, we have filed an antitrust suit against the Chicago Board of Trade seeking injunctive relief against the fixing of minimum commission rates on that leading commodity exchange, the sponsor of the new CBOE.[3]

There is a trend toward eliminating the traditional fixed rates on various exchanges—or stated alternatively there has been no showing that fixed commissions are necessary to make any exchange system work. *Cf. Silver* v. *New York Stock Exchange,* 373 U.S. at 357. The Commission has eliminated fixed commission rates on securities transactions of large size on existing registered national securities exchanges and has promised to lower the size of the transaction subject to negotiated rates in the future.

[2] See *Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure,* SEC File No. 4-144 (January, 1969); *Statement of the United States Department of Justice,* SEC File No. 4-147 (December, 1971).

[3] *United States* v. *Board of Trade of the City of Chicago,* Civil No. 71C2875 (N.D. Ill.).

The Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, has recommended that all fixed rates be eliminated.[4] Within the securities industry itself, a growing number of prominent persons have recommended the elimination of fixed rates.[5]

A parallel trend can be seen on the nation's commodity exchanges. Most of the larger exchanges have agreed, in settlement of antitrust suits, to phase out entirely fixed commission rates over a period of several years.[6] The Administrator, Commodity Exchange Authority, after careful study, concluded that the orderly elimination of fixed rates would prove beneficial to traders on commodity exchanges without adverse consequences to the brokerage industry.[7] A recently organized commodity exchange, at the urging of the administrator, deleted fixed minimum rates from its proposed rules.[8]

These developments suggest that it would be highly undesirable for the Commission to approve fixed commission rates on a new exchange which is about to be registered. Even if it is appropriate to allow a prompt but gradual phase-out of fixed rates on established

[4] Securities Industry Study Report of the Subcommittee on Commerce and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, Aug. 23, 1972, pp. XIV; 131–146.

[5] See *Statement of the United States Department of Justice*, *supra*, pp. 6–8.

[6] See documents filed in *Arenson* v. *Chicago Mercantile Exchange*, Civil No. 71C854 (N.D. Ill.).

[7] See *A Report on the Rules and Practices of the Chicago Board of Trade Concerning Minimum Rates of Commission and Brokerage Fees*, Administrator, Commodity Exchange Authority July, 1972.

[8] See Rules of the Pacific Commodities Exchange, Inc. on file with the Commodity Exchange Authority.

exchanges, this cannot justify present approval (or non-disapproval) of fixed rates for exchanges not yet in existence. Such a course would be plainly contrary to the broad public interest in a competitive economy. See *U.S.* v. *Philadelphia National Bank*, 374 U.S. 321, 372 (1963); *Thill; supra.* It would also—unwisely—expose the members of the CBOE to possible treble damage liability under the antitrust laws. While there may be some question about the appropriateness of such damages for long established practices of existing exchanges,[9] no considerations of laches, estoppel or reliance would be present in the case of the CBOE.

We therefore request that the Commission disapprove proposed Rule 14 of the CBOE on the ground that it unnecessarily interferes with competition. Cf. *Thill*, 433 F. 2d at 271–2; *Rules of the New York Stock Exchange*, 10 S.E.C. 270 (1941). In the alternative, if it grants approval, (or non-disapproval), we request that it formally notify the Department of Justice of (i) the reasons for its action, and (ii) the legal status of the rule under the securities laws. See *Ricci* v. *Chicago Mercantile Exchange*, (Supreme Court, Jan. 9, 1972) slip opinion, p. 15, fn. 14.

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Antitrust Division.

DONALD I. BAKER,
BARRY GROSSMAN,
DANIEL R. HUNTER,
Attorneys,
Department of Justice.

JANUARY 15, 1973.

[9] See Comments of Judge Swgert in *Thill*, 433 F. 2d at 277.

Securities Exchange Act

Release No. 9985, February 1, 1973

In the Matter of the Chicago Board Options Exchange, Inc.

FINDINGS AND OPINIONS OF THE COMMISSION

The Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), a Delaware non-stock corporation organized to establish an auction market dealing in put and call options, filed with us an application for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934 ("Exchange Act").[1] In response to public notice of the filing of the application and our invitation for comments thereon, certain comments were submitted to us by the American Stockholders Association, Inc., the American Stock Exchange and the Antitrust Division of the United States Department of Justice, all of which have been carefully considered.

Under Section 6(d) of the Exchange Act we are required to cause an exchange applying for registration to be registered as a national securities exchange if it appears to us that the exchange is so organized as to be able to comply with the provisions of the Act and the rules and regulations thereunder and

[1] Pursuant to the Exchange's consent, action on its application as amended has been deferred pending the issuance of these findings and opinion.

that the rules of the exchange are just and adequate to insure fair dealing and to protect investors.

After a review of CBOE's application in accordance with these standards, we have determined to grant the registration of the Exchange. In taking this action, we note that the CBOE will not be able to commence exchange operations immediately, since it appears that it will first be necessary for the Exchange (or its subsidiary, The Chicago Board Options Exchange Clearing Corporation, which is the issuer of the options to be traded on the Exchange) to effect compliance with the registration requirements of the Securities Act of 1933 and of Section 12(b) of the Exchange Act with respect to the securities for which it proposes to provide an exchange market. Exchange officials are engaged in discussions with our staff with a view to such compliance, the CBOE has agreed to make appropriate filings pursuant to those provisions, and the Exchange's application for registration includes as one of its "stated policies"[2] that it will comply with the registration provisions applicable to the securities to be traded on the Exchange.

We do not believe it is necessary to describe herein the rather voluminous rules and representations of the Exchange which have been filed with us as a part of its application. We do believe, however, that special mention should be made of several of the policy issues considered by us in connection with our review of the CBOE application.

1. Since the CBOE is a new exchange, and the first national securities exchange proposing to provide for

[2] Rule 17a–8 under the Exchange Act, which requires any proposed changes in exchange rules to be submitted to us before being put into effect, defines "rules" to include an exchange's "stated policies."

the trading of puts, calls, or similar options, we have determined to permit it to test the market for such options within a controlled environment. CBOE has stated that it intends to commence operations as a "pilot project" and limit trading on its floor initially to call options in respect of approximately 30 underlying stocks, and increase the number of underlying stocks gradually and extend operations to other types of options as experience is gained and the market and its regulatory arrangements are tested. Also, the Exchange has provided in its rules that the securities underlying the call options must be registered and listed on another national securities exchange and have broad distribution and volume characteristics.[3]

The Exchange has further agreed not to extend its activities to include trading in put options without complying with applicable procedures governing the adoption of new rules by national securities exchanges. These representations and policies announced by the Exchange are, in our view, "rules" of the Exchange and as such will be subject to our review prior to any material change therein. In this connection, we have recently proposed adoption of Rule 9b–1 under the Exchange Act which would provide special procedures relating to the adoption and alteration of rules of registered national securities exchanges concerning "acts or transactions in options."[4] In any event, we intend to maintain close surveillance over the progress of CBOE's "pilot project." For the period of CBOE's experimental status, and in line with the need to maintain flexibility in regulating this new kind of exchange

[3] CBOE Rule 5.3.

[4] Securities Exchange Act Release No. 9930 (January 9, 1973).

market,[5] we have also decided to postpone a definitive determination as to whether CBOE should be required to include in its rules a nonmember access provision.[6] CBOE rules do not now include such a provision.

2. We have also considered the question of CBOE's rules regarding fixed commission rate charges. Under Chapter XIV of its rules, CBOE has adopted a policy of permitting negotiated commission rates on all orders to purchase or sell options having premiums above $30,000, and on orders for exercise of exchange options having a value of more than $30,000 (as measured by the striking price multiplied by the number of shares). It has been suggested by one commen-

[5] As we stated in our release announcing proposed Rule 9b–1: "The Commission is of the opinion that in addition to the novelty of exchange option trading, such trading may involve complex problems and special risks to investors and to the integrity of the marketplace. The Commission therefore believes that, utilizing the broad power granted under Sections 9 and 23 of the Act it should provide itself with a substantial amount of flexibility in carrying out its regulatory responsibilities with respect to option trading on exchanges." [Footnotes omitted.]

[6] "Nonmember access" involves the granting of a percentage discount from the fixed exchange commission rate to nonmember brokers when they trade as agents in listed securities through members on that exchange. Rules providing for such access have been adopted by the other national securities exchanges. Those exchanges do not at present trade in put and call options. We also note that the adoption of nonmember access rules by those exchanges was occasioned mainly by the fact that a great many nonmembers who wished to effect transactions for their customers in listed securities were economically inhibited from doing so by prior exchange rules which prohibited their sharing in the stock exchange commissions generated. If CBOE's experiment is successful and a similar desire for access by nonmembers develops, we will reconsider the question of whether it is appropriate for CBOE to adopt a nonmember access rule.

tator [7] that we should not approve CBOE's rules unless they also provide for negotiated commission rates below the $30,000 level.

In reviewing CBOE's registration application, we have weighed its particular rule provisions against the regulatory objectives of the Exchange Act. Among other things, those objectives embody the concept that exchanges will deal fairly with the public; that exchanges will be organized in such a fashion as to ensure their continued viability in asserting self-regulatory oversight over their members; and that exchanges may, so far as is consonant with other regulatory objectives of that Act, maintain competitive viability with other exchanges. Applying these criteria, we find it in the public interest to declare effective the registration of CBOE on the basis of its present rules, including its rule regarding commission rate charges.

We have been engaged for some time in a painstaking review of the commission rate structure of all national securities exchanges. As a result of that review, we have concluded that fixed commission rates on institutional-sized orders no longer serve any compelling regulatory objective of the Exchange Act and have required each of the existing exchanges to expand the permissible negotiation of commission rates to that portion of securities orders exceeding $300,000.[8] We also have indicated our intention to consider whether this breakpoint on negotiated commission rates should not be lowered to $100,000 provided our analysis of the impact of negotiation of commission rates on orders exceeding $300,000 does not evidence significant regulatory problems.[9] We conclude that CBOE's re-

[7] The Antitrust Division of the U.S. Department of Justice.

[8] See Securities Exchange Act Release No. 9950, pp. 96–108 (January 16, 1973).

[9] *Ibid.*

quirement for negotiation above $30,000 is comparable to the general requirement of negotiated commission rates we previously have enunciated and comports with our general finding that negotiation on large institutional-sized orders is appropriate in the public interest. As we continue our review of the appropriateness of further reductions in the breakpoint for negotiated rates, CBOE will be included in any determinations we may make. In view of these circumstances, we do not find CBOE's proposed rule relating to rates to be unreasonable.

Recognizing CBOE as an experimental project, we believe it would be unwise, at the outset, to cast CBOE into a preconceived mold. We believe it is appropriate, therefore, pending further conclusions regarding the viability of existing fixed commission rates and the nature of CBOE's actual operations, to permit CBOE to structure its commission rates in a manner analogous to those provided by all of the existing exchanges.[10] For these reasons CBOE will be permitted to begin operations with the prevailing exchange practice of fixed minimum rates on portions of orders below an appropriate breakpoint incorporated in its rules.[11] It is understood that CBOE's fixed rates shall continue only so long as they exist on other exchanges and that the breakpoint at which

[10] We previously have enunciated our view that the structuring of a central market system is appropriate in the public interest and that such a system may require a large measure of uniformity. With the advent of increased interest in trading in options, it is difficult to predict what, if any, role in such a central market system CBOE will play. But we do not believe it is appropriate to *mandate* differences in treatment of such fundamental matters as commission rates until further experience with the CBOE pilot project is obtained.

[11] CBOE Rule 14.3.

competitively determined rates begin shall be appropriately adjusted when breakpoints lower than $300,000 are adopted by other exchanges. We are of the opinion that this approach is consistent with the standards of the Exchange Act.

We note that, in connection with the registration of CBOE (and the reported consideration also being given by certain registered exchanges to trading options), we have recently issued three releases proposing new Rule 9b–1,[12] discussed above, and Rule 12a–6,[13] and proposing an amendment to Rule 3a11–1 [14] under the Exchange Act.

Proposed Rule 12a–6 would provide an exemption from the registration provisions of Section 12(a) of the Exchange Act for securities underlying options where the option is itself registered on the national securities exchange in question, the underlying security is registered and listed on another national securities exchange, and the exchange upon which the option is listed limits its activity in the underlying securities to effecting exercises of the options. The proposed amendment to Rule 3a11–1 would clarify the term "equity security" to specifically include calls and puts.

An appropriate order granting exchange registration will issue.

By the Commission (Chairman Casey and Commissioners Herlong and Loomis); Commissioner Owens dissenting.

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[12] Securities Exchange Act Release No. 9930 (January 9, 1973).

[13] Securities Exchange Act Release No. 9931 (January 9, 1973).

[14] Securities Exchange Act Release No. 9929 (January 29, 1973).

ORDER GRANTING REGISTRATION AS NATIONAL SECURITIES EXCHANGE

The Chicago Board Options Exchange, Inc., having filed an application with the Commission for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934; and

It appearing to the Commission that the rules of said exchange provide for the expulsion, suspension or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the willful violation of any provisions of the Act, or of any rule or regulation thereunder, shall be considered conduct or proceeding inconsistent with just and equitable principles of trade; and

It further appearing that said exchange is so organized as to be able to comply with the provisions of said Act and the rules and regulations thereunder, and that the rules of said exchange are just and adequate to insure fair dealing and to protect investors;

It is ordered that the application of The Chicago Board Options Exchange, Inc. for registration as a national securities exchange be, and it hereby is, granted.

By the Commission.

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